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EDITORIAL

Welcome to the sixth edition of The International Comparative Legal Guide to: Securitisation.

This guide provides the international practitioner and in-house counsel with a comprehensive worldwide legal analysis of the laws and regulations of securitisation.

It is divided into two main sections:

Five general chapters. These are designed to provide readers with a comprehensive overview of key securitisation issues, particularly from the perspective of a multi-jurisdictional transaction.

Country question and answer chapters. These provide a broad overview of common issues in securitisation laws and regulations in 36 jurisdictions.

All chapters are written by leading securitisation lawyers and industry specialists and we are extremely grateful for their excellent contributions.

Special thanks are reserved for the contributing editor, Mark Nicolaides of Latham & Watkins LLP, for his invaluable assistance.

Global Legal Group hopes that you find this guide practical and interesting.

The International Comparative Legal Guide series is also available online at www.iclg.co.uk.

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Chapter 1

Documenting Securitisations in Leveraged Finance Transactions

Latham & Watkins LLP

Introduction

Including a receivables securitisation tranche when financing (and refinancing) highly leveraged businesses that generate trade receivables has become popular for several reasons. First and foremost, securitisation financings can generally be obtained at a much lower overall cost to the corporate group. Second, securitisation financings typically do not impose as extensive a package of operational restrictions on the group compared with those found in leveraged finance facility agreements. Finally, many companies engaged in securitisation transactions claim that it helps them improve the efficiency of their underlying business by focussing management attention on the actual performance of customer relationships (e.g. invoice payment speed and volume of post-sale adjustments).

In leveraged finance facility agreements and high yield bond indentures, affirmative and negative covenants restrict the operations of the borrower/issuer and all or certain of its significant (i.e. “restricted”) subsidiaries in a complex and wide-ranging manner. This chapter discusses the manner in which such covenants would need to be modified in order for a borrower/issuer to be able to enter into a receivables securitisation without needing to obtain specific lender or bondholder consent (which is often a costly and challenging process). Although this chapter describes one set of modifications, there are, of course, various means of achieving the same objectives and the transaction documentation must be analysed carefully in each case to determine what exactly is required. This chapter also discusses some of the key negotiating issues involved in negotiating and documenting such covenant modifications.

Once appropriate covenant carve-outs permitting a trade receivables securitisation have been agreed, the securitisation itself can then be structured and documented. Each of the country chapters in the latter part of this guide provides a summary of the issues involved in executing a securitisation in that country.

Typical Transaction Structure

Trade receivables are non-interest bearing corporate obligations typically payable up to 90 days following invoicing. They arise following the delivery of goods or the rendering of services by a company to its customers. As long as a receivable is legally enforceable and not subject to set-off, and satisfies certain other eligibility criteria specific to each transaction, the company to which the receivable is owing can raise financing against it.

One popular form of receivables financing, asset-based lending (ABL), is structured as a loan to a company secured by the receivables. ABL transactions, although popular, have the drawback of exposing ABL lenders to all of the risks of the borrowing company’s business – risks which may lead to the company’s insolvency and (at least) delays in repayment of the ABL lenders.

An alternative form of receivables financing, discussed below, is a “securitisation” of the receivables. A securitisation involves the outright sale of receivables by a company to a special purpose vehicle (SPV), usually a company but also possibly a partnership or other legal entity. The purchase price of receivables will generally equal the face amount of the receivables minus, in most cases, a small discount to cover expected losses on the purchased receivables and financing and other costs of the SPV. The purchase price will typically be paid in two parts: a non-refundable cash component paid at the time of purchase with financing provided to the SPV by senior lenders or commercial paper investors, and a deferred component payable out of collections on the receivables.

In some jurisdictions the deferred component may need to be paid up front (e.g. to accomplish a “true sale” under local law), in which case the SPV must incur subordinated financing, usually from a member of the selling company’s group, to finance that portion of the purchase price. The SPV will grant security over the receivables it acquires and all of its other assets to secure repayment of the financing incurred by it to fund receivables purchases.

The SPV will be structured to have no activities and no liabilities other than what is incidental to owning and distributing the proceeds of the receivables. The SPV will have no employees or offices of its own; instead, the SPV will outsource all of its activities to third parties pursuant to contracts in which the third parties agree not to make claims against the SPV. While the SPV purchaser will often be established as an “orphan company”, with the shares in the company held in a charitable trust, rather than by a member of the target group, in certain jurisdictions and depending on the particular deal structure, it may be necessary to establish an initial purchaser of receivables that is incorporated as a member of the group (which may then on-sell the receivables to an “orphan” SPV).

Collection of the receivables will generally be handled by the selling company or another member of the group pursuant to an outsourcing contract until agreed trigger events occur, at which point a third party servicer can be activated. By these and other contractual provisions the SPV is rendered “bankruptcy remote” and investors in the securitisation are, as a result, less likely to suffer the risks of the insolvency of the borrower of the securitisation debt.

From collections, the SPV will pay various commitment fees, administration fees and interest to its third party suppliers and finance providers. All payments are made pursuant to payment priority
“waterfalls” that govern the order in which parties are paid. Typically, there are separate waterfalls for distributions made prior to enforcement and for distributions made after enforcement commences.

The structure of a typical trade receivables securitisation transaction is as follows:

**Documentation Provisions**

In light of the foregoing, we describe below the provisions necessary to permit a trade receivables securitisation under typical leveraged finance documentation. In summary, the relevant documentation will need to include several framework definitions describing the general terms of the anticipated securitisation transaction and several carve-outs from the restrictive covenants to which the relevant borrower/issuer would otherwise be subject. We address each in turn below.

**Descriptive Definitions**

The following descriptive definitions will need to be added to the relevant transaction documents to describe what is permitted and thus to provide reference points for the covenant carve-outs which follow. These definitions contain various limitations designed to strike a balance between the interests of the owners of the borrower/issuer, on the one hand, who desire to secure the receivables financing on the best possible terms, and the interests of the senior lenders/bondholders, on the other hand, who do not want the terms of the securitisation financing to disrupt the borrower’s ability to repay their (usually much larger) loans or bonds in accordance with their terms. The definitions below are of course negotiable, and the exact scope of the definitions and related provisions will depend on the circumstances of the particular transaction and the needs of the particular group. In particular, where a business is contemplating alternate structures to a trade receivables securitisation, such as a factoring transaction, certain slight modifications may be necessary to one or more of the definitions and related provisions described below.

The definitions below are tailored for a high yield indenture, but they can easily be modified for a senior facility agreement if desired.

“Qualified Receivables Financing” means any financing pursuant to which the Issuer or any of its Restricted Subsidiaries may sell, convey or otherwise transfer to any other Person or grant a security interest in, any accounts receivable (and related assets) in an aggregate principal amount equivalent to the Fair Market Value of such accounts receivable (and related assets) of the Issuer or any of its Restricted Subsidiaries; provided that (a) the covenants, events of default and other provisions applicable to such financing shall be customary for such transactions and shall be on market terms (as determined in good faith by the Issuer’s Board of Directors) at the time such financing is entered into, (b) the interest rate applicable to such financing shall be a market interest rate (as determined in good faith by the Issuer’s Board of Directors) at the time such financing is entered into and (c) such financing shall be non-recourse to the Issuer or any of its Restricted Subsidiaries except to a limited extent customary for such transactions.

“Receivable” means a right to receive payment arising from a sale or lease of goods or services by a Person pursuant to an arrangement with another Person pursuant to which such other Person is obligated to pay for goods or services under terms that permit the purchase of such goods and services on credit, as determined on the basis of applicable generally accepted accounting principles.

“Receivables Assets” means any assets that are or will be the subject of a Qualified Receivables Financing.

“Receivables Fees” means distributions or payments made directly or by means of discounts with respect to any participation interest issued or sold in connection with, and other fees paid to a Person that is not a Restricted Subsidiary in connection with, any Qualified Receivables Financing.

“Receivables Repurchase Obligation” means:

(a) any obligation of a seller of receivables in a Qualified Receivables Financing to repurchase receivables arising as a result of a breach of a representation, warranty or covenant or otherwise, including as a result of a receivable or portion thereof becoming subject to any asserted defense, dispute, off-set or counterclaim of any kind as a result of any action taken by, any failure to take action by or any other event relating to the seller; and

(b) any right of a seller of receivables in a Qualified Receivables Finance to repurchase defaulted receivables in order to obtain any VAT bad debt relief or similar benefit.

“Receivables Subsidiary” means a Subsidiary of the Issuer that engages in no activities other than in connection with a Qualified Receivables Financing and that is designated by the Board of Directors of the Issuer as a Receivables Subsidiary:

(a) no portion of the Indebtedness or any other obligations (contingent or otherwise) of which (i) is guaranteed by the Issuer or any other Restricted Subsidiary of the Issuer (excluding guarantees of obligations (other than the principal of, and interest on, Indebtedness) pursuant to Standard Securitisation Undertakings), (ii) is recourse to or obligates the Issuer or any other Restricted Subsidiary of the Issuer in any way other than pursuant to Standard Securitisation Undertakings, or (iii) subjects any property or asset of the Issuer or any other Restricted Subsidiary of the Issuer, directly or indirectly, contingently or otherwise, to the satisfaction thereof, (other than accounts receivable and related assets as provided in the definition of Qualified Receivables Financing) other than pursuant to Standard Securitisation Undertakings;

(b) with which neither the Issuer nor any other Restricted Subsidiary of the Issuer has any contract, agreement, arrangement or understanding other than on terms which the Issuer reasonably believes to be no less favorable to the Issuer or such Restricted Subsidiary than those that might be obtained at the time from Persons that are not Affiliates of the Issuer; and

(c) to which neither the Issuer nor any other Restricted Subsidiary of the Issuer has any obligation to maintain or preserve such Subsidiary’s financial condition or cause such Subsidiary to achieve certain levels of operating results.

Any such designation by the Board of Directors of the Issuer shall be evidenced to the Trustee by filing with the Trustee a copy of the resolution of the Board of Directors of the Issuer giving effect to such designation and an Officer’s Certificate certifying that such designation complied with the foregoing conditions.
"Standard Securitisation Undertakings" means representations, warranties, covenants, indemnities and guarantees of performance entered into by the Issuer or any Subsidiary of the Issuer which the Issuer has determined in good faith to be customary in a Receivables Financing, including those relating to the servicing of the assets of a Receivables Subsidiary, it being understood that any Receivables Repurchase Obligation shall be deemed to be a Standard Securitisation Undertaking.

**Qualified Receivables Financing Criteria**

In addition to the descriptive definitions above, the documentation may also set out certain criteria which the Qualified Receivables Financing would have to meet in order to be permitted. These criteria will often be transaction specific or relate to certain commercial terms, in which case they may not be needed in addition to the requirements for market or customary provisions already incorporated into the descriptive definitions above (see “Key Issues” below). However, if required, these may include:

- minimum credit ratings (for underlying debt or the securities issued pursuant to the securitisation);
- conditions as to who may arrange the securitisation;
- notification obligations in respect of the main commercial terms;
- requirement to ensure representations, warranties, undertakings and events of defaults/early amortisation events are no more onerous than the senior financing; and/or
- other economic terms (e.g. a cap on the weighted average cost of interest and third party credit enhancement payable).

**Covenant Carve-outs**

In a typical senior facility agreement or high yield indenture, the securitisation transaction must be carved out of several covenants, described in further detail below. In summary, carve-outs will need to be created for the following restrictive covenants:

- Asset sales/disposals.
- Indebtedness.
- Liens/negative pledge.
- Restricted payments.
- Limitations on restrictions on distributions from restricted subsidiaries.
- Affiliate transactions/arm’s length terms.
- Financial covenants (in the case of facility debt only).

**Limitation on asset sales/disposals**

Typically in a leveraged facility agreement, the relevant borrower may not, and may not permit any of its subsidiaries to, sell, lease, transfer or otherwise dispose of assets (other than up to a certain permitted value), except in the ordinary course of trading or subject to certain other limited exceptions. Similarly, in a typical high yield indenture, the issuer may not, and may not permit any of its “restricted subsidiaries” to make any direct or indirect sale, lease (other than an operating lease entered into in the ordinary course of business), transfer, issuance or other disposition, of shares of capital stock of a subsidiary (other than directors’ qualifying shares), property or other assets (referred to collectively as an “Asset Disposition”), unless the proceeds of such disposition are applied in accordance with the indenture (which will regulate how the net disposal proceeds must be invested).

In connection with a Qualified Receivables Transaction the relevant borrower and its restricted subsidiaries will sell receivables and those sales would otherwise be caught by such a restriction. Thus, the relevant documentation should contain an explicit carve-out, typically in the case of a high yield indenture from the definition of “Asset Disposition”, along the following lines:

(--) sales or dispositions of receivables in connection with any Qualified Receivables Financing;

A similar carve-out can be included in the restrictive covenant relating to disposals in a loan facility agreement, or in the definition of “Permitted Disposal” or “Permitted Transaction”, where applicable.

**Limitation on indebtedness**

In a leveraged facility agreement the relevant borrower group is often greatly restricted in its ability to incur third-party financial indebtedness other than in the ordinary course of its trade (again, often subject to a permitted debt basket and certain other limited exceptions). In a high yield indenture, the issuer and its restricted subsidiaries are normally restricted from incurring indebtedness other than “ratio debt” (e.g. when the fixed charge or leverage ratio of the group is at or below a specified level), subject to limited exceptions. In a high yield indenture, the term “Indebtedness” typically covers a wide variety of obligations.

A receivables subsidiary in connection with a qualified receivables transaction will incur various payment obligations that would otherwise be caught by such a restriction, particularly if the financing is raised in the form of a secured loan made to the receivables subsidiary. Thus, if a borrower/issuer desires to retain the ability to continue to obtain funding under a receivables securitisation even if the leverage of the group is too high to permit the incurrence of third-party financings (or if the permitted debt basket is insufficient), the relevant documentation should contain an explicit carve-out from the indebtedness restrictive covenant along the following lines:

(--) indebtedness incurred by a Receivables Subsidiary in a Qualified Receivables Financing;

Alternatively, one could exclude the securitisation transaction from the definition of “Indebtedness” directly:

The term “Indebtedness” shall not include . . . (--) obligations and contingent obligations under or in respect of Qualified Receivables Financings.

It should be noted that an exclusion from “Indebtedness” may have an impact on other provisions such as the cross default or financial covenants so it should therefore be considered carefully in each of the different contexts in which it would apply (see also “Financial Covenants” below).

Subject to the same considerations, a similar carve-out can be included in the restrictive covenant relating to the incurrence of Financial Indebtedness in a loan facility agreement, or in the definition of “Permitted Financial Indebtedness” or “Permitted Transaction”, where applicable.

**Mandatory prepayment of other debt from the proceeds of securitisations**

In a leveraged facility agreement, the carve-outs from disposals and “Indebtedness” described above may be subject to a cap, above which any such amounts are either prohibited absolutely or subject to mandatory prepayment of other debt. Whether, and to what extent, the proceeds of securitisations should be used to prepay debt can often be heavily negotiated. The business may wish to use such proceeds for general working capital purposes while lenders would be concerned at the additional indebtedness incurred by a borrower group which may already be highly leveraged.

If some form of mandatory prepayment is agreed, this will often be limited to the initial proceeds of the securitisation so that the borrower is not required to keep prepaying as new receivables...
replace existing receivables. A simple way to incorporate this into
the loan documentation would be to carve out ongoing proceeds
from the proceeds which are required to be prepaid:

“Excluded Qualified Receivables Financing Proceeds” means any
proceeds of a Qualified Receivables Financing to the extent such
proceeds arise in relation to receivables which replace maturing
receivables under that or another Qualified Receivables Financing;

“Qualified Receivables Financing Proceeds” means the proceeds
of any Qualified Receivables Financing received by any member of
the Group except for Excluded Qualified Receivables Financing
Proceeds and after deducting:

(a) fees, costs and expenses in relation to such Qualified
Receivables Financing which are incurred by any member of
the Group to persons who are not members of the Group; and
(b) any Tax incurred or required to be paid by any member of the
Group in connection with such Qualified Receivables Financing (as reasonably determined by the relevant
member of the Group, on the basis of existing rates and
taking into account of available credit, deduction or
allowance) or the transfer thereof intra-Group,
to the extent they exceed, in aggregate for the Group, [--] in any
financial year.

Limitation on liens/negative pledge

In a leveraged facility agreement, the borrower and other members
of the group will be restricted from creating or permitting to subsist
any security interest over any of their assets, other than as arising
by operation of law or in the ordinary course of trade (again often
subject to a permitted security basket and certain other limited
exceptions). Similarly, in a typical high yield indenture, an issuer
may not, and may not permit any of its restricted subsidiaries to,
incure or suffer to exist, directly or indirectly, any mortgage, pledge,
security interest, encumbrance, lien or charge of any kind
(including any conditional sale or other title retention agreement or
lease in the nature thereof) upon any of its property or assets,
whenever acquired, or any interest therein or any income or profits
therefrom (referred to collectively as “Liens”), unless such Liens
also secure the high yield debt (either on a senior or equal basis,
depending on the nature of the other secured debt). As with
leveraged loan facilities, typically, there is a carve-out for
“Permitted Liens” that provide certain limited exceptions.

A receivables subsidiary in connection with a qualified receivables
transaction will grant or incur various Liens in favour of the
providers of the securitisation financing that would otherwise be
caught by the restriction, particularly if the financing is raised in the
form of a secured loan made to the receivables subsidiary. Thus, the
relevant documentation should contain an explicit carve-out from
the Lien restriction, along the lines of one or more paragraphs added
to the definition of “Permitted Lien”:

(→) Liens on Receivables Assets Incurred in connection with a
Qualified Receivables Financing; and

(→) Liens securing Indebtedness or other obligations of a
Receivables Subsidiary;

A similar carve-out can be included in the negative pledge in a loan
facility agreement, or in the definition of “Permitted Security” or
“Permitted Transaction”, where applicable.

Limitation on restricted payments

Typically, in a leveraged facility agreement, the borrower and its
subsidiaries may not make payments and distributions out of the
restricted group to the equity holders or in respect of subordinated
shareholder debt. Similarly, in a typical high yield indenture, an
issuer may not, and may not permit any of its restricted subsidiaries
to, make various payments to its equity holders, including any
dividends or distributions on or in respect of capital stock, or
purchases, redemptions, retirements or other acquisitions for value
of any capital stock, or principal payments on, or purchases,
repurchases, redemptions, defeasances or other acquisitions or
retirements for value of, prior to scheduled maturity, scheduled
repayments or scheduled sinking fund payments, any subordinated
indebtedness (as such term may be defined).

A receivables subsidiary in connection with a qualified receivables
financing will need to pay various fees that may be caught by this
restriction. Thus, the relevant documentation should contain an
explicit carve-out from the restricted payment covenant, along the
following lines:

(→) payment of any Receivables Fees and purchases of Receivables
Assets pursuant to a Receivables Repurchase Obligation in
connection with a Qualified Receivables Financing;

A similar carve-out can be included in the restrictive covenants
relating to dividends and restricted payments in a loan facility
agreement, or in the definition of “Permitted Distribution” or
“Permitted Transaction”, where applicable.

Limitation on restrictions on distributions from restricted
subsidiaries

In a typical high yield indenture, issuer may not permit any of its
restricted subsidiaries to create or otherwise cause or permit to exist
or to become effective any consensual encumbrance or consensual
restriction on the ability of any restricted subsidiary to make various
restricted payments, make loans, and otherwise make transfers of
assets or property to such borrower/issuer.

A receivables subsidiary in connection with a qualified receivables
financing will have restrictions placed on its ability to distribute
cash to parties in the form of payment priority “waterfalls” that
would otherwise usually be caught by such a restriction. Thus, the
relevant document should contain an explicit carve-out from the
limitation on restrictions on distributions, etc., along the following
lines:

(→) restrictions effected in connection with a Qualified Receivables
Financing that, in the good faith determination of an Officer or the
Board of Directors of the Issuer, are necessary or advisable to effect
such Qualified Receivables Financing;

Limitation on affiliate transactions/arm’s length terms

Typically, in a leveraged facility agreement, the borrower and its
subsidiaries will not be allowed to enter into transactions other than
on an arm’s length basis. Similarly, in a typical high yield
indenture, an issuer may not, and may not permit any of its
restricted subsidiaries to, enter into or conduct any transaction or
series of related transactions (including the purchase, sale, lease or
exchange of any property or the rendering of any service) with any
affiliate unless such transaction is on arm’s length terms.

Depending on the value of such transaction, an issuer may be
required to get a “fairness opinion” from an independent financial
adviser or similar evidencing that the terms are not materially less
favorable to the issuer (or to the relevant restricted subsidiary) as
would be achieved on an arm’s length transaction with a third party.

A receivables subsidiary in connection with a qualified receivables
transaction will need to engage in multiple affiliate transactions
because it will purchase Receivables from other members of the
Group on an on-going basis and a variety of contractual obligations
will arise in connection with such purchases. While the terms of
such financing may be structured to qualify as a true sale, and be on
arm’s length terms, the potential requirement to obtain a “fairness
opinion” from an independent financial adviser in connection with
each such transaction is an additional burden that the business will
want to avoid, and the indenture will therefore need to contain an
explicit carve-out from the restriction on affiliate transactions, along the following lines:

(--) any transaction between or among the Issuer and any Restricted Subsidiary (or entity that becomes a Restricted Subsidiary as a result of such transaction) or between or among Restricted Subsidiaries or any Receivables Subsidiary, effected as part of a Qualified Receivables Financing;

A similar carve-out can be included in the restrictive covenant relating to arm’s length transactions in a loan facility agreement, or in the definition of “Permitted Transaction”, where applicable.

**Financial Covenants**

In addition to the carve-outs described above, the parties will also need to consider carefully whether the activities of the borrower and its subsidiaries in connection with Qualified Receivables Financings may impact the testing of financial covenants in a leveraged facility agreement. Although high yield indentures will typically not contain maintenance covenant, the testing of financial ratios is still important for the purposes of determining whether a particular action may be taken by an issuer or a restricted subsidiary under the high yield indenture at a particular time, or indeed to determine whether a subsidiary must be designated as a “restricted subsidiary” in the first place.

In a high yield indenture, important carve-outs can be accomplished by excluding the effects of the securitisation financing from two key definitions (to the extent not already excluded):

“Consolidated EBITDA” for any period means, without duplication, the Consolidated Net Income for such period, plus the following to the extent deducted in calculating such Consolidated Net Income (1) Consolidated Interest Expense and Receivables Fees; (--) . . .

“Consolidated Interest Expense” means, for any period (in each case, determined on the basis of UK GAAP), the consolidated net interest income/expense of the Issuer and its Restricted Subsidiaries, whether paid or accrued, plus or including (without duplication) . . . Notwithstanding any of the foregoing, Consolidated Interest Expense shall not include (i) . . . (--) any commissions, discounts, yield and other fees and charges related to a Qualified Receivables Financing.

The treatment of financial covenant definitions in a leveraged facility agreement is complex, and care should be taken to ensure that the treatment of receivables securitisations in the various related definitions is consistent with the base case model used to set the financial covenant levels and with the applicable accounting treatments. Examples of definitions which should take into account receivables securitisations include, the definitions of “Borrowings”, “Finance Charges” and “Debt Service”.

**Key Issues**

Should an early amortisation of the securitisation facility constitute a cross-acceleration or cross-default to the leveraged finance facility or high yield bonds?

Leveraged finance facility agreements typically contain a clause providing that the loans can be declared to be repayable immediately should an event of default occur with respect to some third party debt or should such third party debt become payable before its scheduled maturity. High yield bond indentures contain a similar provision, but only triggered upon a payment default under or acceleration of the third-party debt. A receivables securitisation financing can be structured so that there is no debt, and therefore no events of default or acceleration can occur. Instead, receivables financings enter into so-called early amortisation pursuant to which the receivables collections that would normally have been paid to the borrower’s group to acquire new receivables is paid instead to the provider of the receivables financing.

The commercial risk to lenders and bondholders should an early amortisation event occur is that the cut-off of funds could cause a sudden and severe liquidity crisis at the borrower’s group. Thus, subject to a materiality threshold below which the parties agree that the sudden loss of liquidity is not material, cross-default and cross-acceleration triggers in leveraged finance facilities and high yield bond indentures should be tripped if an early amortisation event occurs under a receivables financing facility.

How might the non-renewal of the securitisation program affect the leveraged loans and the high yield bonds?

For historical reasons, most securitisation facilities must be renewed every year by the receivables funding providers. The leveraged loans and high yield bonds, on the other hand, have far longer maturities. The non-renewal of a securitisation facility prior to the maturity of the leveraged loans and high yield bonds can cause a liquidity crisis at the borrower’s group in the same manner as any early amortisation event, and should be picked up in the leveraged finance and high yield documentation in a comparable manner.

Should there be any limits to the size of the securitisation facility? If so, how should those limits be defined?

By its nature, a securitisation financing removes the most liquid assets of a borrower group – the short term cash payments owing to the group from its customers – from the reach of the leveraged lenders and high yield bondholders. Moreover, the amount of new receivables financing raised will never equal the full face value of the receivables sold, because the receivables financing providers will advance funds on the basis of some “advance rate” or subject to certain “reserves” which result in the new funding equalling 75 per cent to 80 per cent of the full face value of the receivables at best. On the other hand, a receivables financing delivers to the borrower group, the lenders and bondholders alike the benefits of lower-cost funding and liquidity. Where the balance between these two competing factors should be struck is for negotiation among the parties, but some balance in the form of a limit to the overall size of the receivables facility seems appropriate.

Should a limit be agreed, the residual question is how that limit should be defined. There are two main options. The limit can be defined by reference to the total outstanding value at any point in time of receivables sold, or it can be defined by reference to the total receivables financing raised. The disadvantage of the latter approach is that it rewards receivables financings with poor advance rates. If a receivables financing has an advance rate of 80 per cent, £500 million face value of receivables is needed to raise £400 million of financing. On the other hand, if a receivables financing has an advance rate of only 50 per cent, £800 million face value of receivables is needed to raise the same £400 million of financing. In the latter example, the leverage lenders and high yield bondholders lose more receivables for little or no additional cost or liquidity benefit.

Should “ineligible” receivables be sold?

This issue functions commercially in much the same manner as the advance rate issue discussed immediately above. As summarised at the beginning of this chapter, receivables funding providers only advance funds against receivables that satisfy certain specified eligibility standards. That requirement, however, does not mean that the “ineligible” receivables are any less likely to be paid or that they have actual payment rates that are any less sound compared with eligible receivables. However, the advance rate against an
ineligible receivable is 0 per cent and, as a result, including them in the pool of sold receivables will reduce the effective overall advance rate against the pool, with the adverse impact for lenders and bondholders described above. Accordingly, if ineligible receivables constitute any meaningful percentage of a group’s total receivables, it makes sense to require that ineligible receivables be excluded from the receivables financing.

**Should proceeds raised under the securitisation facility be used to repay debt?**

The required and permitted use of proceeds of a securitisation financing is always a key point of negotiation. The outcome of those negotiations will depend upon many diverse factors, including whether the group’s liquidity needs are met by one of the leveraged loan facilities and whether the borrower’s group can bear the higher overall debt burden should no debt repayment be required.

**Should the lenders/bondholders regulate the specific terms of the securitisation?**

Sponsors prefer that the receivables financing carve-outs permit any programme which a responsible officer of the borrower determines in good faith is “on market terms” which is “in the aggregate economically fair and reasonable” to the borrower/issuer and the group. This approach is, in general, the correct one. As indicated above, however, certain issues are sufficiently important for the parties to agree upon in advance. Beyond these and possibly a handful of additional issues, neither lenders nor bondholders should have the right specifically to approve the documentation of the receivables financing facility.

**Conclusion**

In summary, with very little modification to the standard leveraged loan or high yield documentation, a trade receivables securitisation financing can easily be added as part of a leveraged buy-out financing or refinancing, thereby providing financing directly to the relevant corporate group on comparatively favourable terms.
Chapter 2

CLOs: An Expanding Platform

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At the beginning of 2011, the collateralised loan obligation (“CLO”) market was poised to make a comeback. In The International Comparative Legal Guide to: Securitisation 2011 chapter we authored entitled “On the CLO Horizon – Regulations Expected to Impact CLOs” (the “CLO Regulations Chapter”) we discussed the new or proposed regulations that might affect the growth of the CLO market. Moreover in 2011, we did, in fact, see a modest revival of CLOs. New issuance for the year totaled approximately €12.3 billion. In The International Comparative Legal Guide to: Securitisation 2012 we authored a chapter entitled “New Structural Features for Collateralised Loan Obligations” which discussed the structural changes being made to the governing documents for a post-financial crisis CLO, which has become known as CLO 2.0. Those changes helped foster the growth in the CLO market last year, when new issuance reached approximately $55 billion. Industry participants are predicting that new issuance in 2013 will exceed that level and reach $65 billion to $75 billion and, in fact, issuance so far in 2013 is on a pace that would exceed that amount. 2013 will also see an expansion of the CLO market into new asset classes and new markets, and a return of the European CLO. However, there continue to be regulatory and market challenges for CLOs.

Return of the European CLO

Unlike the United States, where the recovery in the leveraged loan market continues and the pace of new CLO issuances continues to increase, Europe has seen no significant CLO activity since the credit crisis. However, the European market appears to be slowly picking up, with one transaction successfully pricing in February 2013 and others in the pipeline. If these offerings are successful, industry participants estimate that in 2013 we could see from €3 billion to €5 billion of new CLO issuance, increasing to €5 billion to €7 billion in 2014.

The European CLO market faces significant hurdles on the way to recovery. The relative scarcity of leveraged loans in the European primary market has made it more difficult for prospective CLO managers to assemble marketable portfolios of loans. The European institutional loan market has fallen from pre-crisis levels to a 2012 low of €150 billion in new issuances, and pre-crisis crisis European CLOs are reaching the end of their reinvestment periods. As these CLOs begin to unwind, and pre-crisis crisis loans begin to come due (between now and 2015), the conditions are in place for strong demand for new financing.

A second hurdle is Article 122a of the European Union’s Capital Requirements Directive (“Article 122a”). Article 122a’s five per cent risk retention requirement (discussed below) is a potentially impossible burden for less-well-capitalised managers. The first European CLO to price in 2013 is reported to have complied with this risk retention requirement by arranging for a structured credit fund to hold the equity.

Unlike in the U.S. market, where 2013 CLOs have employed leverage equal to as much as ten times the equity tranche, the new wave of European CLOs are expected to be significantly less leveraged. Concentration limitations and portfolio criteria are expected to be broadly in line with current CLO 2.0 standards in the United States, except that collateral obligations must be Euro-denominated.

Emerging Market CLOs

Issuance of CLOs that invest in emerging market (“EM”) leveraged loans and debt securities came to a halt in 2008. 2012 saw the successful offering of the first post-credit crisis CLO that invests primarily in leveraged loans and debt issued by EM borrowers. The notes issued by this CLO generally had higher spreads than comparable CLOs issued to invest in U.S. leveraged loans, and the leverage was lower.

The portfolio requirements for this new EM CLO and for others that are following in its wake are similar to the current CLO 2.0 criteria for U.S. CLOs as a result of rating agency methodology and investor preferences. Obligations are U.S. Dollar-denominated, and most of the portfolio is required to be first-priority senior secured loans. Unlike in earlier EM CLOs, the amount of EM sovereign obligations that new EM CLOs can buy is more limited (ten per cent in a recent CLO) and hedging is limited to interest rate hedges and short credit default swaps on obligations owned by the CLO. The concentration limitations are structured to provide significant flexibility to invest in most of the major EM markets. There are also substantial non-EM buckets to permit the CLO to acquire collateral if suitable EM collateral is not available.

Other CLOs focused on EM debt markets are appearing in the market, but there remain significant obstacles. Bloomberg recently reported that prices for non-investment-grade EM debt are at their highest level in seven years. The demand for quality EM debt may make assembling CLO portfolios more challenging. If these CLOs will make extensive investments in loans and debt securities that are not denominated in U.S. Dollars, it will be necessary to issue liabilities in other currencies or confront the hedging issues discussed below.

High-Yield CBOs

One of the early structured credit products, known as a collateralised bond obligation (“CBO”), invested primarily in high-
yield bonds, and pre-credit crisis CLOs often had the capacity to invest a large portion of the portfolio in high-yield bonds. However, CLO 2.0 transactions have limited high-yield bonds to five per cent to ten per cent of the portfolio. Recently, managers have begun early-stage marketing of hybrid CLO/CBOs which would have the capacity to invest a majority of the portfolio in high-yield bonds. A few recent CLOs have permitted a larger portion (e.g., 40 per cent) of the portfolio to be invested in high-yield bonds than the typical five per cent to ten per cent limit.

The challenges to a revival of CBOs include the losses that investors experienced on some pre-credit crisis CBOs, and the differences in terms (interest rate, maturity, covenants, security and seniority) between a typical senior secured loan and a typical high-yield bond. CLOs that invest in high-yield bonds are unlikely to qualify for the exemption from the U.S. risk retention requirements (discussed below), and are more likely to need to enter into hedging instruments (also discussed below). The revival of CLOs that invest in high-yield bonds is being facilitated by the increasing use of floating rates on high-yield bonds, the increased issuance of senior secured bonds and the greater acceptance by CLO investors of covenant lite (“cov lite”) terms (which are often found in high-yield bond indentures).

### CRE CDOs

Pre-credit crisis Commercial Real Estate CDOs (known as “CRE CDOs”) invested in many different kinds of assets, including CMBS, commercial mortgages of varying quality and seniority, B notes, loan participations, and even tranches of other CRE CDOs. Beginning in 2012 and continuing in 2013, established players in the commercial mortgage market have begun to remake the CRE CDO as a specialty commercial real estate product focusing on proven, but sometimes more risky, segments of the CRE market.

Sponsors of “CRE CDO 2.0” transactions prefer to call their offerings a “CRE resecuritisation” or a “mortgage CLO”. These transactions also have been structured to more closely resemble CLO transactions, rather than pre-credit crisis CRE CDOs.

In 2012, the first of the CRE CDO 2.0 transactions (marketed as a “mortgage collateralised loan obligation”) was offered by a subsidiary of a real estate investment trust. Others have followed, and still more are in marketing. The terms have generally been more conservative than in pre-credit crisis CRE CDOs. For example, one transaction was fully ramped at closing, and the portfolio criteria limited its assets solely to whole loans and senior participations secured by multi-family properties. Another CRE CDO consisted of a static portfolio primarily consisting of mezzanine and B-note positions.

CRE CDOs can play an important role if they remain focused on sectors of the commercial mortgage market that are not currently well-served by CMBS.

### Challenges for CLOs in 2013

#### Sourcing Collateral

Although market insiders predict a robust market for CLO offerings, even CLOs that primarily invest in senior secured loans to U.S. borrowers face challenges. One of the main challenges this year is sourcing collateral with a yield sufficient for the equity investors in a CLO to receive an attractive return after interest is paid on the senior notes.1 Due to the growth in the CLO market and other market trends (such as the growth of retail investor-oriented loan funds), spreads on leveraged loans in the United States have declined. Unless the spread on senior CLO notes continues to tighten, the equity returns may not be high enough to attract investors. In addition, maintenance covenants in new credit agreements have fallen by the wayside, forcing CLOs to invest more in cov lite loans. This has resulted in increases in the concentration limit on cov lite loans in CLO indentures and redefinition of what is a cov lite loan to more closely reflect current loan market practices.

### Risk Retention

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) mandated the U.S. Securities and Exchange Commission (“SEC”) and Federal banking agencies (the “Agencies” and, together with the SEC, the “Joint Regulators”) to adopt regulations requiring the sponsor of a securitisation to retain not less than five per cent of the aggregate credit risk. In March 2011, the Joint Regulators issued proposed rules (the “CRR Proposal”) to implement the risk retention requirement. The Agencies proposed that CLOs would be subject to the risk retention requirement and concluded that the collateral manager should be viewed as the “sponsor” which must retain at least five per cent of the risk. (Alternatively, lenders which originated a significant percentage of the loans could retain the risk.) The only CLOs that the Agencies proposed to exempt from this requirement would be ones that invested only in commercial loans that met very strict underwriting standards and satisfied other conditions summarised in our CLO Regulations Chapter.

Several industry organisations, including the American Securitization Forum (“ASF”) and the Loan Syndications and Trading Association (“LSTA”) submitted comments to the regulators, asking them to reconsider whether CLOs should be subject to risk retention. The LSTA asserted that, as a matter of statutory interpretation, managers of CLOs that purchase syndicated commercial loans in the open market are not subject to risk retention requirements because their activities do not meet the definition of “securitiser” in section 941 of the Dodd-Frank Act. The ASF argued that risk retention was not needed in the CLO market to avoid the “originate to distribute” problem that afflicted other types of pre-credit crisis securitisations, because the manager of a CLO rarely originates the loans purchased by a CLO; moreover, the management fee structure used in most CLOs aligns the interests of the CLO manager with the interests of investors, because the manager subordinates part of its fee to payments on the senior notes and receives a private equity-style incentive fee only after the equity investors have achieved a specified return on their investments. Both the LSTA and the ASF asked that, if the regulators conclude that risk retention applies to CLOs, they should exempt from risk retention any CLO that meets specified criteria; however, they pointed out that no CLO could meet the criteria for an exempt CLO set forth in the CRR Proposal. The LSTA’s suggested criteria included the following: the portfolio must be limited to corporate credit obligations, cash and temporary liquidity investments, 90 per cent of which must be senior secured syndicated loans; purchases in an initial commercial loan syndication transaction would be limited to circumstances where multiple financial institutions can acquire loans through the syndication process; underlying obligors must be commercial borrowers; no asset-backed securities; no synthetic assets; managers must be registered investment advisers; and compensation to the manager must be structured to align its interest with the CLO investors.
As of the date of this writing, the proposed rule has not been finalised. The recent adoption of a rule defining a “qualified mortgage” by the Consumer Financial Protection Bureau was expected to lead to regulatory action on the CRR Proposal. However, this is now in doubt because the director of the Bureau, Richard Cordray, was appointed by President Barack Obama without U.S. Senate confirmation during the Senate’s recess, and a federal appeals court ruled that the president’s recess appointments to the National Labor Relations Board — which were made at the same time as Mr. Cordray’s appointment — were unconstitutional.

Article 122a applies to new securitisations, including CLOs, which issued securities after 31 December 2010. Article 122a imposes a significant capital charge on securitisation securities acquired by a European Economic Area (“EEA”) regulated credit institution, unless the originator, sponsor or original lender of the securitisation has disclosed to the EEA-regulated credit institution that it will retain, for the life of the transaction, a net economic interest of not less than five per cent of specified credit risk tranches. As of the date of this writing, most CLOs have not complied with Article 122a. However, a few CLOs that invest in U.S. loans have complied with Article 122a, and as discussed above new European CLOs in the market are planning to comply. Article 122A permits a third-party equity investor in the CLO to retain the risk if it is involved in structuring the transaction and selecting the assets, as well as being involved in any material changes to the transaction. The equity investor may be a fund, provided that it is not a fund which is controlled by, or managed by, the investment manager of the CLO.

Foreign Account Tax Compliance Act

On 17 January 2013, the U.S. Treasury issued final regulations that provide guidance on Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986, as amended (commonly referred to as the “FATCA”). FATCA generally requires foreign financial institutions (“FFIs”), including CLOs, to enter into information sharing agreements with the U.S. Internal Revenue Service (the “IRS”) and report certain information about their U.S. accounts to the IRS on an annual basis in order to avoid a 30 per cent withholding on certain U.S.-connected payments (including U.S. source interests and gross sale proceeds from the disposition of U.S. debt obligations). The final regulations provide that FATCA withholdings will not apply to any U.S. debt obligations outstanding on 1 January 2014, unless such obligations are materially modified after that date, and treat certain entities in existence on 31 December 2011 as deemed-compliant FFIs through 31 December 2016 if, among other things, the organisational documents do not permit amendments without the agreement of all of such entity’s holders. However, because most CLOs require only a two-third majority for consent, among other reasons, this temporary relief is unlikely to provide much respite to pre-FATCA CLOs, absent further guidance from the IRS. The U.S. Treasury is developing an alternative approach for FFIs resident in a country that has entered into an intergovernmental agreement (“IGA”) with the United States. The United States and the Cayman Islands are working together on an IGA, but it is unclear whether, and when, a United States and Cayman Islands IGA will be put in place and how such an IGA would impact CLOs.

Volcker Rule

Section 619 of the Dodd-Frank Act (commonly referred to as the “Volcker Rule”) prohibits a “banking entity” from acquiring or retaining an equity, partnership, or other ownership interest in, or sponsoring, any hedge fund or private equity fund. The terms “hedge fund” and “private equity fund” include any issuer that does not register with the SEC as an investment company under the U.S. Investment Company Act of 1940 (the “Investment Company Act”) based on the exceptions in Section 3(c)(1) or Section 3(c)(7) thereof, and any “similar fund”. Most (but not all) CLOs have been structured as “3(c)(7)” vehicles, which limit investors (or, in the case of CLOs domiciled outside of the United States, U.S. investors) to “qualified purchasers” (as defined in Section 2(51)(A) of the Investment Company Act). Therefore, most managed or “arbitrage” CLOs will fall under the purview of the Volcker Rule as currently drafted, despite the fact that CLOs are not regarded by market participants as either hedge funds or private equity funds. “Balance sheet” CLOs, which banks use for regulatory capital efficiency by transferring loans (or the credit risk of the loans) from its balance sheet to the CLO and then holding the equity in the CLO, can also be structured as Section 3(c)(7) vehicles, in which event the prohibitions on banking entity sponsorship and ownership contained in the Volcker Rule would apply. In addition, the Volcker Rule may restrict the warehouse arrangements used to accumulate loans for a CLO if the placement agent is a banking entity and is regarded as the sponsor or adviser to the CLO, because the warehouse facility could constitute a prohibited covered transaction under Section 23A of the U.S. Federal Reserve Act. These problems can be avoided if the regulations implementing the Volcker Rule do not treat CLOs as hedge funds or private equity funds. Alternatively, CLOs can escape the Volcker Rule if they are offered without relying on Section 3(c)(1) or Section 3(c)(7) and escape characterisation as a “similar fund”. Many balance sheet CLOs and some managed or arbitrage CLOs have been structured to qualify for the SEC’s Rule 3a-7 exemption for issuers of ABS. However, Rule 3a-7 imposes many restrictions and is best suited for static or very lightly managed CLOs that do not invest in credit default swaps.

Industry participants have argued that the Volcker Rule should not apply to CLOs, because the Volcker Rule includes a provision that “nothing in the rule limit or restrict the sale or securitization of loans” and a CLO is essentially a loan securitisation.

As of the date of this writing, no further action has been taken on the Volcker Rule by the federal regulators.

CFTC CPO Registration for CLOs

Any securitisation vehicle, including a CLO, which enters into a swap (including an interest rate or currency swap and some types of credit default swaps) is considered by the U.S. Commodity Futures Trading Commission (“CFTC”) to be a “commodity pool” under Section 1a(10) of the U.S. Commodity Exchange Act and under the CFTC’s Regulation 4.10(d). As a result, the collateral manager of the CLO is required to register with the CFTC as a CPO (“commodity pool operator”) or CTA (“commodity trading adviser”) unless there is an applicable exemption. Most CLOs qualified for an exemption under the CFTC’s Regulation 4.13(a)(4) because they required all U.S. investors to be “qualified purchasers”. However, that exemption was revoked by the CFTC in 2012.

Few, if any, post-credit crisis CLOs have entered into swaps. Nonetheless, most of these CLOs are authorised to enter into swaps and they may need to hedge as they invest more in fixed rate assets or in assets denominated in a different currency than their liabilities. In any event, pre-credit crisis CLOs which entered into swaps are subject to these new requirements.
The CFTC staff recognised that securitisations, including CLOs, would become subject to these registration requirements for the first time and issued an interpretation letter on 11 October 2012, excluding securitisation vehicles that met certain conditions from the definition of “commodity pool”. Most CLOs could not meet these conditions because their investment activities are much more active than contemplated by this interpretation letter. In a subsequent interpretation and no-action letter issued by the CFTC staff on 7 December 2012, the staff provided further exclusions from commodity pool regulation for securitisation vehicles. In CFTC Letter No. 12-45, one example of a securitisation vehicle that would not be a commodity pool is a traditional CLO or CDO that (i) owns only financial assets consisting of corporate loans, corporate bonds, or investment-grade, fixed-income mortgage-backed securities, asset-backed securities or CDO tranches issued by vehicles that are not commodity pools, (ii) is permitted to trade up to 20 per cent of the aggregate principal balance of all financial assets owned by the issuer per year for three years, and (iii) uses interest rate swaps to convert fixed rate financial assets to floating and foreign exchange swaps to convert Euro-denominated assets to Dollars, and none of these swaps may be terminated before the related hedged asset has been liquidated. However, this letter stated that if a CLO used swaps to create investment exposure, then the securitisation vehicle may be a commodity pool.

CFTC Letter No. 12-45 also provided no-action relief for securitisation vehicles, including CLOs, formed prior to 12 October 2012 if specified criteria were met. The CLO must not issue securities on, or after, 12 October 2012 and its securities must be backed by payments on, or proceeds received in respect of, and their creditworthiness must primarily depend upon, cash or synthetic assets owned by the CLO. Note that legacy securitisation vehicles, unlike new CLOs that rely on the exclusions described in the prior paragraph, are permitted to hold synthetic assets.

CFTC Letter No. 12-45 also granted temporary no-action relief for securitisation vehicles unable to rely upon CFTC Letter No. 12-14 or CFTC Letter No. 12-45 until 31 March 2013.

Hedging

As CLOs expand beyond funding investments in U.S. Dollar-denominated floating rate loans with U.S. Dollar-denominated floating rate liabilities to CLOs which also invest in fixed rate bonds or in assets denominated in multiple currencies and fund with fixed and floating rate liabilities and multi-currency liabilities, the need to enter into hedging arrangements will increase. In addition to the CFTC regulatory framework discussed above, these new CLOs will face other issues. Since the financial crisis, rating agency requirements for hedge counterparties have become more stringent, and the credit ratings of many of the dealers which traditionally provided swaps to CLOs have been reduced. This combination of heightened agency requirements with reduced dealer credit ratings makes hedging currency or interest rate risks challenging for these new types of CLOs. For example, this concern is evident in emerging market and European CLOs.

Rating agencies have consistently required ratings triggers for hedge counterparties that enter into hedge agreements in CLO transactions so that the issuer can de-link the counterparty risk of the hedge counterparty from the credit risk of the CLO. For a CLO which issues notes rated by Moody’s, the counterparty must have a specified minimum rating and, if the counterparty gets downgraded below a specified ratings trigger, then the hedge counterparty must obtain a guarantee, replace itself or post collateral. If the hedge counterparty is further downgraded below a lower specified ratings trigger then the hedge counterparty must obtain a guarantee or replace itself and post additional collateral in the interim. Moody’s new rating agency framework has additional requirements, including requiring execution of all ISDA documentation at close, including a credit support annex that incorporates specific collateral amounts and valuation percentages and requiring amendments to standard ISDA provisions and clarifying certain events of default and termination events. Standard & Poor’s takes a similar approach — the underpinning of its counterparty criteria is the replacement of a counterparty when its creditworthiness deteriorates. Their criteria combine minimum eligible counterparty ratings, collateral amounts and remedy periods to support a maximum potential rating on the securities. The basis for the criteria is that similar credit quality may be achieved through balancing the minimum eligible counterparty rating and the collateral amount, where lower minimum eligible counterparty ratings result in higher collateral amounts. If the counterparty gets downgraded below a certain level it must replace itself or obtain a guarantee from an appropriately rated guarantor.

The CLO market in the United States made a triumphant return in 2012 and CLO issuance is on a pace this year to surpass last year’s strong numbers. This market is expanding to include other similar financial products — the European CLO, the emerging market CLO and an expansion into asset classes such as high-yield bonds and commercial mortgage related assets.

Endnotes

1. The most junior tranche in a CLO often consists of subordinated notes which do not bear an interest rate, but also may be preferred shares, limited liability company or limited partnership interests or certificates. For convenience, we refer to all of these CLO securities as “equity”.

2. Directive 2009/111/EC of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management. Article 122a applies to new CLO transactions issued on, or after, 1 January 2011, and existing CLO transactions where new underlying exposures are added or substituted after 31 December 2014.

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Chapter 3

US Taxation of Non-US Investors in Securitisation Transactions

Ashurst LLP

A. Introduction

This chapter discusses, in plain business English, special US tax rules applicable to non-US investors in securitisation transactions. These rules include, among others, a 30 per cent US withholding tax on non-US investors and the ability of non-US investors to hold securities in bearer form. For a more detailed discussion of the topics covered in this chapter, complete with citations to the relevant primary authorities, readers should see chapter 12 of James M. Peaslee & David Z. Nirenberg, FEDERAL INCOME TAXATION OF SEURITIZATION TRANSACTIONS AND RELATED TOPICS (4th Ed., Frank J. Fabozzi Associates 2011) from which this chapter is derived. More information about the book and free updates are available at www.securitizationtax.com.

This chapter also discusses the effect on mortgage-backed securities of the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA). The chapter finishes with a discussion of the Foreign Account Tax Compliance Act (FATCA) rules enacted on 18 March 2010, which generally will apply to payments made after 31 December 2013. This legislation requires foreign entities to monitor and report on accounts or ownership interests held directly or indirectly by specified US persons. Its purpose is to prevent US persons from avoiding tax by hiding income earned through foreign accounts and entities. Noncompliance is penalised through a special additional withholding tax.

Except where otherwise noted, it is assumed in this chapter that a non-US investor has no connection with the United States other than the holding of the asset-backed security under discussion, and specifically that the investor does not hold the security in connection with a US trade or business conducted by the investor. In very general terms, income of a non-US investor that is effectively connected with a US trade or business of the investor is subject to US income tax at the rates applicable to domestic taxpayers. A non-US investor buying an asset-backed security need not fear that it will be deemed to be in bearer form if it is currently in bearer form, or if there is a right to convert it into bearer form at any time during the remaining period that it is outstanding.

The issuance of a registration-required obligation in bearer form can result in severe sanctions to the issuer. The issuer of a registration-required obligation in bearer form is presentment of the instrument to the issuer (or its paying agent). Thus, the issuer would have no need or ability to track changes in ownership of the instrument. Accordingly, there would be no easy paper trail for the IRS to follow in identifying owners.

With a view to increasing taxpayer compliance, TEFRA amended the Code to prohibit, with limited exceptions, the issuance or holding of debt obligations in the United States in bearer form. Specifically, the TEFRA rules require all registration-required obligations (as defined below) to be in registered form. (The TEFRA registration requirements are tax related and distinct from any need to register securities with the Securities and Exchange Commission or state agencies under US securities laws.)

An obligation is in registered form for these purposes if (1) it is registered as to both principal and interest with the issuer or its agent and can be transferred only by specified US persons. Its purpose is to prevent US persons from avoiding tax by hiding income earned through foreign accounts and entities. Noncompliance is penalised through a special additional withholding tax.

Except where otherwise noted, it is assumed in this chapter that a non-US investor has no connection with the United States other than the holding of the asset-backed security under discussion, and specifically that the investor does not hold the security in connection with a US trade or business conducted by the investor. In very general terms, income of a non-US investor that is effectively connected with a US trade or business of the investor is subject to US income tax at the rates applicable to domestic taxpayers. A non-US investor buying an asset-backed security need not fear that it will be deemed to be in bearer form if it is currently in bearer form, or if there is a right to convert it into bearer form at any time during the remaining period that it is outstanding.

The issuance of a registration-required obligation in bearer form can result in severe sanctions to the issuer. The issuer of a registration-required obligation in bearer form is presentment of the instrument to the issuer (or its paying agent). Thus, the issuer would have no need or ability to track changes in ownership of the instrument. Accordingly, there would be no easy paper trail for the IRS to follow in identifying owners.

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B. TEFRA Registration Requirements

1. Overview

A debt instrument in bearer form may be transferred by assignment and delivery. Further, the only prerequisite to receiving payments on such a debt instrument is presentment of the instrument to the issuer (or its paying agent). Thus, the issuer would have no need or ability to track changes in ownership of the instrument. Accordingly, there would be no easy paper trail for the IRS to follow in identifying owners.

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withholding tax on interest (described below). The sanctions described in the two preceding sentences generally affect only US issuers or issuers that are owned (in whole or in part) by US persons, but the excise tax is potentially applicable to all issuers.

Any US taxpayer that holds a registration-required obligation in bearer form in violation of the TEFRA rules is also subject to certain tax penalties. In general, the holder of a registration-required obligation in bearer form is denied deductions for any loss from the obligation, and any gain from the obligation that otherwise would be capital gain is converted into ordinary income. The holder sanctions apply to an obligation only if the issuer was not subject to the excise tax (described above), and thus are generally a concern only for debt obligations that were issued under the Eurobond exception described below.

A registration-required obligation is defined generally as any obligation other than one that: is issued by an individual; is not of a type offered to the public; or has a maturity at issue of not more than one year. Thus, the TEFRA registration requirements do not apply directly to home mortgages and other consumer receivables that are obligations of individuals. In fact, such obligations are almost never issued or held in registered form. Conventional commercial loans and mortgages are generally not of a type offered to the public and traditionally have been issued in bearer form. However, because interest on bearer securities not issued under the Eurobond exception generally cannot be paid to a foreign holder free of US withholding tax (see below), many commercial loans and commercial mortgages are now issued in registered form.

For purposes of applying the issuer sanctions only, an obligation is not registration-required if it is issued under the Eurobond exception, which allows bearer paper to be offered outside of the United States to non-US investors. As discussed below, for obligations issued after 18 March 2012, the Eurobond exception will continue to apply only for purposes of applying the issuer excise tax.

In general, an obligation qualifies for the Eurobond exception if (1) the obligation is “targeted” to non-US investors upon its original issuance, (2) the obligation provides for interest to be payable only outside the United States, and (3) for any period during which the obligation is held other than in temporary global form, the obligation and each coupon contain a TEFRA legend. For an obligation to be targeted to non-US investors there must be, in the language of the statute, “arrangements reasonably designed to ensure” that the obligation “will be sold (or resold in connection with the original issue) only to a person who is not a United States person”. To satisfy this arrangements test, generally it is necessary to meet detailed restrictions on offers, sales, and deliveries of obligations during an initial “seasoning” period and to obtain certifications as to the non-US status of investors.

The HIRE Act limited the scope of the Eurobond exception for obligations issued after 18 March 2012, so that it will continue to apply only as an exception to the issuer excise tax. Thus, registration-required obligations issued after that date in bearer form will be subject to the other issuer sanctions (including denial of interest deductions) and will not be eligible for the portfolio interest exemption. What this means in practical terms is that the Eurobond exemption will no longer be available with respect to obligations issued after 18 March 2012, for issuers that are domestic taxpayers or owned by domestic taxpayers because interest on bearer paper would not be deductible.

2. Asset-Backed Securities

The TEFRA rules apply in a straightforward way to pay-through bonds, pass-through debt certificates, and REMIC regular interests. They are registration-required obligations and must be issued in registered form unless the Eurobond exception applies. Although REMIC residual interests are probably not “obligations” for TEFRA purposes, under the REMIC rules, they cannot be issued in bearer form without jeopardising the issuer’s status as a REMIC.

The treatment of pass-through certificates under the TEFRA rules is more complex. Except where otherwise noted, it is assumed in this discussion that the issuing trust is classified for tax purposes as a trust. For substantive tax purposes, pass-through certificates are not recognised to be debt of the issuing trust; instead, they merely evidence ownership of the trust assets. It would make little sense, however, to exclude pass-through certificates from the reach of the TEFRA rules. They are generally liquid securities similar to traded debt instruments. Further, applying a look-through approach would produce odd consequences. The pass-through certificates would not be subject to the registration requirement if the underlying trust assets were obligations of individuals or loans not of a type offered to the public. If the trust assets included any registration-required obligations, it would not be possible to issue certificates in bearer form under the Eurobond exception.

These unsettling results are avoided under regulations that effectively treat pass-through certificates (as defined in the regulations) as obligations of the issuing trust for TEFRA purposes. Thus, the nature of the underlying obligations is irrelevant in applying the TEFRA rules to such certificates. The certificates must be in registered form unless the Eurobond exception applies based on an offering of the certificates (as distinguished from the obligations held by the trust) outside of the United States.

The regulations define a “pass-through certificate” as a “pass-through or participation certificate evidencing an interest in a pool of mortgage loans” (emphasis added) to which the grantor trust rules apply, or a “similar evidence of interest in a similar pooled fund or pooled trust treated as a grantor trust”. Apart from an example of a trust holding 1,000 residential mortgages, the regulations offer no guidance on the meaning of the term “pool”.

C. Withholding Tax

1. Overview

In general, a non-US investor that receives fixed or determinable annual or periodical income (FDAP income) from US sources is subject to a 30 per cent tax on the gross amount of such income, unless either a statutory exemption applies or the tax is reduced or eliminated under an income tax treaty between the United States and the investor’s country of residence. The tax is required to be collected and paid over to the Internal Revenue Service (the Service) by any withholding agent in the chain of payment, but is due whether or not it is collected by withholding.

The two types of income that are likely to be earned by an investor in asset-backed securities are interest and gain from the sale or exchange of the securities. Although interest is FDAP income, gain from the sale or exchange of securities, including gain attributable to market discount and option premium, is not. Gain representing accrued original issue discount is treated as interest and thus is FDAP income. Thus, the withholding tax discussion herein concentrates on interest income. Certain other types of FDAP income that may be earned from asset-backed securities are discussed below.

In general, interest income is subject to the withholding tax if it is derived from US sources, unless either the exemption for portfolio interest (described below) applies, or the tax is reduced or
eliminated under a treaty. In some cases, tax may be required to be withheld from payments of interest even if those payments are not includible in full in the income of the payee. The investor, however, would be entitled to a refund of any excess tax withheld. Special rules apply to original issue discount, and to dividends paid by a mutual fund out of interest income.

The source of interest income depends on the status of the borrower. Interest is generally US source if the borrower is a resident of the United States or is organised in the United States. Thus, interest on all of the following typically would be sourced in the United States: a pass-through certificate issued by a grantor trust holding obligations of US residents, and pay-through bonds; and pass-through debt certificates that are considered debt of a US resident. Pay-through bonds issued by an entity classified as a partnership would be US source if the entity is engaged in a US trade or business, and bonds of a US grantor trust or disregarded entity would be sourced as if the debt were issued directly by the owner(s).

A specific rule treats excess inclusion income earned on a REMIC residual interest as domestic source income in all cases. Otherwise, there is no explicit source rule for REMIC interests. It is highly likely, however, that income from both regular and residual interests would be sourced in the United States if the issuing REMIC is organised and operated in the United States and the underlying mortgages are obligations of US borrowers. Apart from the source question, the withholding tax applies to REMIC regular interests in the same way that it applies to conventional debt obligations.

Income on a REMIC residual interest representing a share of the REMIC’s taxable income is treated as interest for withholding tax purposes. No exemption from such tax or reduction in rate applies to the portion of the income from a residual interest that is an excess inclusion. In the limited cases in which income from a REMIC residual interest is considered to be derived from sources outside of the United States (now only of historical interest for excess inclusion income), such income should not be subject to US withholding tax, even if it is an excess inclusion. The withholding tax generally is imposed on income from a residual interest when such income is paid or distributed (or when the interest is disposed of). Such income may have to be taken into account earlier, under regulations, if the residual interest does not have significant value. Thus far, this grant of authority has been used sparingly, only to require accelerated withholding for partnerships allocating income from residual interests to foreign partners (these rules are described below). Outside of the partnership context, the REMIC regulations prevent underwithholding by providing that a purported transfer of a residual interest to a non-US investor is ignored for tax purposes—with the hapless transferor retaining ownership of the interest for tax purposes—unless the residual interest is reasonably expected to produce cash distributions sufficient to pay withholding tax liabilities no later than the close of the calendar year following the year in which the related income accrues.

For withholding tax purposes, the holder of an equity interest in a domestic partnership or trust is treated essentially as if it owned directly the underlying receivables, and the partnership or trust acts as a withholding agent. Thus, the 30 per cent tax, to the extent it applies, is based on the gross amount of interest received by the partnership or trust. This rule poses a risk for an owner trust that applies interest it receives to pay debt service on pay-through bonds without allowing for a withholding tax. Such a trust and its domestic equity owners have an interest in ensuring that any interest allocable to equity interests held by a non-US investor are exempt from withholding tax, either as portfolio interest or under a tax treaty.

A special withholding regime applies to REMIC residual interests held by domestic partnerships (and certain other pass-through entities) that make it clear that a taxpayer cannot avoid tax on income from non-economic residual interests by having the interests be held by a domestic partnership and allocating income from them to foreign partners.

2. Portfolio Interest Exemption

Notwithstanding the general rules discussed above, interest is exempt from withholding tax if such interest qualifies as portfolio interest. With limited exceptions—most significantly, for payments of interest to 10 per cent corporate shareholders or partners, to related controlled foreign corporations, or to banks of interest under bank loans, and for certain payments of contingent interest—interest on an obligation (including OID) is portfolio interest if (1) the obligation is in bearer form, and was issued on or before 18 March 2012 in compliance with the Eurobond exception to the TEFRA registration requirements described above, or (2) the obligation is in registered form, and the withholding agent receives a statement from the beneficial owner or certain intermediaries giving the owner’s name and address and certifying that the owner is not a US person. In the case of an obligation issued prior to 1 January 2009 in “targeted registered” form, a more lenient certification procedure applies if the obligation is held through an appropriate foreign financial institution. In such a case, the financial institution need only certify that the beneficial owner of the obligation is not a US person, without disclosing the beneficial owner’s identity. The targeted registered rules have been eliminated for securities issued on, or after, 1 January 2009, although they continue to apply to outstanding securities.

There are three basic approaches to applying the portfolio interest exemption to asset-backed securities, which reflect differences in the degree to which the securities are treated as stand-alone securities or instead as interests in the underlying receivables. This distinction is important because, as noted above, consumer receivables typically are not in registered form and are not issued under the Eurobond exception. Accordingly, interest on such receivables received directly by investors would not be eligible for the portfolio interest exemption. The same may be true for certain short-term debt obligations.

Pay-through bonds and REMIC regular interests are considered debt instruments in their own right and thus can qualify for the portfolio interest exemption based on their own characteristics regardless of the date of origination or bearer or registered status of the underlying receivables. As is true with other debt, the portfolio interest exemption would not apply if the lender was considered a 10 per cent shareholder of the borrower. In applying that limitation, careful consideration should be given to the possible application of conduit principles if the issuer of receivables is related to the lender.

At the other extreme, a full-look-through approach applies to any security that is considered a partnership interest (including interests in most owner trusts and pass-through certificates issued by trusts that have characteristics that prevent them from qualifying as trusts). Thus, the portfolio interest exemption is applied as if the partners owned directly the partnership assets. REMIC residual interests fall into the look-through camp, but are subject to the overriding principle that any income that is an excess exclusion is not eligible for any exemption from withholding tax, including the portfolio interest exemption. Interests in grantor trusts that do not hold “pools” of loans (see the following paragraph) are also subject to a look-through approach.

The last category of securities is pass-through certificates representing interests in grantor trusts holding pools of debt obligations. Although pass-through certificates are generally taxed...
on a full look-through basis, as discussed above, a special rule treats such certificates as separate obligations for the purposes of applying the TEFRA registration requirements. The same logic carries over to the portfolio interest exemption, so interest received on such certificates is considered to be received on the certificates rather than on the underlying receivables. However, the 18 July 1984 effective date of the portfolio interest exemption is applied based on when the underlying trust assets were issued.

Portfolio interest does not include any interest that, with certain exceptions, is contingent on the profits or cash flow of the debtor (or a related person), the value of the debtor’s (or a related person’s) property, or distributions on the debtor’s (or a related person’s) equity. Thus, such interest will generally be subject to the 30 per cent withholding tax unless the tax is eliminated or reduced under a treaty. Of particular relevance to securitisations, the contingent interest exclusion does not apply to interest that is considered contingent solely on account of (1) a contingency as to the timing of any interest or principal payment, (2) the debt being nonrecourse or limited recourse, or (3) the interest being determined by reference to interest that itself is not contingent (or by reference to the principal amount of debt that does not bear contingent interest). While asset-backed securities may provide for payments that depend on cash flows of the issuer, these exceptions cover the features of typical asset-backed securities that are likely to raise questions. Other exceptions are available that are less likely to be relevant in securitisations.

### 3. Swaps, Rents, Options, and Debt-Related Fees

**a. NPC Income**. Some asset-backed securities represent ownership interests in a trust holding both (1) a debt instrument (including a REMIC regular interest) or pass-through certificate, and (2) a notional principal contract (NPC), such as an interest rate swap, cap or floor agreement. The trust may be classified for tax purposes as either a grantor trust or a partnership. The withholding tax treatment of income from the debt instruments held by the trust is discussed above and would not change because the securities are held in combination with an NPC.

The income from payments received on the NPC generally would be FDAP income. Thus, the income would be subject to US withholding tax unless the tax is eliminated or reduced under a tax treaty, or the source of the income is outside of the United States. (The portfolio interest exemption would not apply because swap income is not interest.) In fact, the withholding tax never applies to income from an NPC as such because such income is sourced based on the residence of the payee, not the residence of the payor. However, to the extent there is a significant non-periodic payment under an NPC, the instrument is generally split for tax purposes into an on-market NPC and a deemed loan. If a non-US investor is the lender, the withholding tax treatment of the deemed interest income (specifically whether the portfolio interest exemption or some other relief applies) must be considered separately from the rules for NPCs. There are special rules for dividend equivalent swap payments that are not generally relevant to securitisations.

A non-US investor that owns an interest in an NPC through a grantor trust clearly would benefit from the NPC source rule based on the investor’s residence, since the trust would be ignored. Due to a change in law in 1997, the result generally would be the same for a non-US investor holding an NPC through a partnership, provided the activities of the partnership are limited (as they typically are with asset-backed securities in which foreigners invest) to investing and trading in securities.

A credit default swap generally would be considered either an NPC or a put option and payments thereunder would not be subject to withholding tax under either theory (options are discussed below). This statement would not apply, however, to a credit default swap that relates to an identified debt instrument held by the protection buyer if the arrangement were recast as a guarantee. In that case, periodic premium payments made to the protection seller would be subject to the withholding tax rules governing guarantee fees, which generally are less favourable to taxpayers.

**b. Rents**. Rental income from real property located in the United States is considered US source FDAP income. There is no withholding tax exemption for such income comparable to the one for portfolio interest. Thus, if a non-US investor holds pass-through certificates or other equity interests in an entity that is taxed for federal income tax purposes as either a trust or a partnership, and the issuer acquires US real property in connection with a default or anticipated default on a mortgage, the withholding tax generally would apply to the investor’s share of any rents received on the property. Interesting allocation issues arise where pass-through certificates are divided into junior and senior classes. On the other hand, income earned on an instrument that is taxed as debt of the issuer, such as a pay-through bond or REMIC regular interest, continues to be interest even if it is derived from rental income. Although uncertain, it appears that all income on a REMIC residual interest would be treated as interest income for withholding tax purposes regardless of the REMIC’s sources of income.

**c. Option Income**. Income from options (including gain of an option writer from the lapse of an option) is considered gain from the sale or exchange of property. Accordingly, such income is not FDAP income and is not subject to the 30 per cent withholding tax.

**d. Debt-Related Fees**. A creditor may receive various income amounts denominated as “fees” in connection with extending credit. How withholding tax rules apply to fees received by a non-US person depends on how they are characterised for tax purposes, which should depend on their economic substance. For example, fees may represent interest if paid as additional consideration for lending funds, or may instead be compensation for some ancillary service provided to a borrower and represent income from personal services. Certain fees may be treated as gain from the sale or exchange of property.

Fees that are not gained from the sale or exchange of property would be FDAP income and thus potentially would be subject to withholding tax if received from US sources. The applicable source rule will depend on the type of income involved. Income from personal services is sourced where the services are performed.

In recent years, the Service has issued guidance on a number of miscellaneous types of “fees” charged in connection with credit card accounts, which is helpful in providing a framework for analysing fees. The guidance generally divides the fees between interest and services income depending on whether they are tied to funded amounts. For example, fees charged as penalties for making late payments are interest and annual fees charged for issuing a credit card (whether or not the card is used) are services income.

Commitment fees are amounts paid by a prospective lender for an agreement of a prospective lender to lend on agreed terms. There are authorities treating such fees in the hands of domestic taxpayers as payments for a property right akin to an option. If this characterisation holds true for withholding tax purposes, income from commitment fees would not be FDAP income, although the point is not clear. Even if commitment fees were considered FDAP income, they might be sourced outside of the United States on the ground that they are more analogous to gain from the disposition of a property right than to other types of income, or on the ground that...
the commitment represents a use of the taxpayer’s capital which is located outside of the United States.

Fees received for consenting to the amendment or waiver of the terms of a debt instrument would not be FDAP income if the amendment or waiver results in a deemed exchange of the debt instrument, so that the fee is properly considered part of the consideration received in an exchange of the unmodified instrument. Where that is not the case, the outcome depends on whether the fees are properly regarded as additional interest, a fee for services, or compensation for the relinquishment of a property right. The source of the income also needs to be considered. Fees may be paid to accept credit risk on obligations of a third party. The withholding tax treatment of these fees is currently uncertain.

D. FIRPTA

FIRPTA subjects non-US investors to US tax on gains from sales of certain United States real property interests (including equity interests in “United States real property holding corporations”) in the same manner as if such gains were effectively connected with a US trade or business. The FIRPTA rules do not apply to interests in real property that are solely creditor interests.

If, however, a non-US investor holds a mortgage-backed security taxable as an equity interest in a grantor trust or partnership and the issuer acquires a real property interest in connection with a mortgage default, the investor will generally be treated for the purposes of FIRPTA as owning a non-creditor interest in such property. Any gain attributable to such property that is allocable to the investor will be taxed under FIRPTA, either when the owning entity disposes of the real property, or when the investor disposes of its interest in the entity. A creditor acquiring real property collateral generally would have a basis in the acquired real property equal to its fair market value at the time of acquisition, so that any gain would be limited to increases in the property’s value during the period it is held by the entity. A REMIC regular interest should be treated as a creditor interest that is not subject to the FIRPTA tax without regard to any holdings of real property by the issuer.

E. FATCA Reporting and Withholding Tax

1. Introduction

The FATCA regime, enacted in 2010 by the HIRE Act and generally effective from the beginning of 2014, imposes a 30 per cent withholding tax on withholdable payments made to a foreign financial institution (FFI), generally without regard to whether the FFI is the beneficial owner of the payment, unless the FFI enters into an agreement (FFI Agreement) with the Service that obligates it, among other things, to report to the Service information about United States accounts or the FFI qualifies for an exemption from the requirement. Subject to exceptions, FATCA also imposes a 30 per cent withholding tax on withholdable payments made to all other foreign entities (referred to as non-financial foreign entities (NFFEs)), provided an NFFE is the beneficial owner of the payment, unless the NFFE is either an active entity or the withholding agent receives a certification as to the ownership of the NFFE by US persons.

Currently, the withholding tax will apply to payments made after 31 December 2013. A grandfathering rule provides that withholding is not required for payments in respect of obligations outstanding as of 31 December 2013. As originally enacted, the statutory provisions would have required withholding to apply to payments made after 31 December 2012 and the grandfathering date would have been a much earlier date of 18 March 2012. The FATCA withholding tax is not intended to duplicate the regular 30 per cent withholding tax on income paid to non-US investors if it otherwise would apply. Taxes that are withheld may be refunded or credited if the beneficial owner is entitled to a reduced rate of withholding pursuant to an income tax treaty with the United States, or, in the case of a beneficial owner that is an NFFE, if it certifies that it does not have any substantial US owners or identifies its substantial US owners or provides documentation establishing that withholding is not required.

Unlike the conventional rules governing withholding tax on payments to non-US investors, the FATCA regime focuses on payments to foreign entities (not individuals) and has as its goal identifying ultimate US (not foreign) owners of the payments (both individuals and closely held corporations) who may be hiding behind foreign entities. Consistent with this goal, the rules do not generally require the reporting to the Service of income amounts but instead the identities of the US owners and the existence and size of accounts and gross payments. Further, although withholdable payments are limited to payments having, broadly speaking, a US source, the required reporting is not. Thus, an FFI receiving US source payments may be compelled by the threat of withholding on those payments to report on unrelated foreign source income earned by US persons. Congress clearly viewed the withholding taxes as a club to compel compliance with reporting obligations, rather than a new revenue source (aside from the revenue picked up through greater compliance with existing income tax obligations).

The discussion below first addresses the statute as modified by Treasury regulations. The application of FATCA, however, is modified by intergovernmental agreements (IGAs) between the United States and various countries around the world. These agreements are discussed in section E.8., below. However, a brief summary of the IGAs is included in the introduction in order to make the discussions of the statute and the FATCA regulations more clear.

On 26 July 2012, the United States released a model intergovernmental agreement (Model 1 IGA), for the implementation of a set of rules modifying the application of FATCA to FFIs (Model 1 FFIs) resident in countries that enter into bilateral agreements based on the Model 1 IGA (each such country, a Model 1 Partner Country). The most significant aspect of the Model 1 IGA is that a Model 1 FFI will not be required to enter into an FFI agreement with the Service. Instead, the Model 1 FFI will be required to comply with the reporting, withholding, and other obligations delineated in the applicable IGA. Two versions of the Model 1 IGA were released—one providing for an automatic reciprocal information exchange by the United States and the Model 1 Partner Country and the other, a non-reciprocal version, providing for a flow of information only to the United States from the Model 1 Partner Country. The United States and the United Kingdom entered into the first IGA, based on the reciprocal version of the Model 1 IGA, on 12 September 2012. The Model 1 IGA and the variations in certain of the concluded agreements are discussed in section E.8.(i), below.

On 14 November 2012, the US Treasury released a second model intergovernmental agreement (Model 2 IGA). The most significant aspect of the Model 2 IGA is that an FFI (Model 2 FFI) resident in a country with respect to which a Model 2 Agreement is in place (each such country, a Model 2 Partner Country) will be permitted and required by its home country law to register with the Service by 1 January 2014 and to comply with the requirements of an FFI
Agreement. The Model 2 Agreement is discussed in section E.8(ii), below.

In a press release, dated 8 November 2012, the Treasury announced that it was engaged in discussions with more than 50 countries to address FATCA compliance. The press release listed each country in one of three categories: (i) countries in the process of finalising IGAs; (ii) countries engaging in dialogue towards concluding IGAs; and (iii) countries exploring options for IGAs. The Cayman Islands, the most significant place of organisation for offshore securitisation vehicles holding US assets, is listed as a country engaging in a dialogue towards concluding an intergovernmental agreement. Luxembourg, the location of many securitisation vehicles holding predominantly European assets, is listed as a country exploring options for an intergovernmental agreement.

2. FATCA Overview and Definitions

The FATCA rules use a number of defined terms. This summary will begin by defining the most significant terms (as defined in the relevant Code section as modified by Treasury regulations) and then describe the substantive rules for FFIs and NFFEs.

A withholdable payment is the kind of payment to which the new withholding tax applies. It is defined as US source FDAP income, and gross proceeds from the sale or other disposition of property of a type which can produce US source interest or dividends (including dividend equivalent payments under swaps). Thus, it includes income amounts not normally subject to withholding tax such as gains on the sale of property and amounts representing a return of capital. There is an exception for an item of income (not payments) effectively connected with a US trade or business. A passthru payment is a withholdable payment and any foreign passthru payment. Thus, a withholdable payment that is received by an FFI but owned by and paid to another person would be a passthru payment. Although the FATCA regulations have been finalised, Treasury has continued to defer on drafting a definition of foreign passthru payments. Withholding on foreign passthru payments (the non-US source portion of passthru payments) and the gross proceeds portion of withholdable payments (i.e., obligations of a type that could produce US source interest or US source dividends) has been delayed until at least 1 January 2017 from the statutory effective date of 1 January 2013. The effective withholding date for any portion of a passthru payment that constitutes US source FDAP income is 1 January 2014, also delayed from the statutory effective date of 1 January 2013. The additional delay in effective dates for foreign passthru payments and gross proceeds is intended to give Treasury more time to consider how withholding should be applied to such payments. Currently, it is unclear how foreign passthru payment withholding will apply. Previously, the Service had proposed an “US assets based approach” that would have treated a portion of the passthru payment that was not a withholdable payment as US source.

A withholding agent is the person required to withhold from withholdable payments or foreign passthru payments and is broadly defined as any person, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of such a payment. The term is not limited to US persons.

A foreign financial institution or FFI is the type of foreign entity that must agree to report on its accounts or suffer withholding on all withholdable payments it receives. Except as provided in an IGA, FFIs generally include the following foreign entities:

- certain foreign insurance companies;
- certain holding companies and treasury centers that are part of financial groups or that are “formed in connection with or are availed of” by investment vehicles;
- entities that conduct one or more of the following activities on behalf of customers: (i) trading in money market instruments, securities, currencies commodities and certain derivative instruments; (ii) portfolio management; or (iii) otherwise investing, administering or managing funds, money or financial assets; and
- professionally managed investment funds (i.e., entities whose gross income is primarily attributable to investing, reinvesting or trading in financial assets) or other entities that function or hold themselves out as collective investment vehicles that are established to invest, reinvest or trade in financial assets (e.g., hedge funds, private equity funds, securitisation vehicles and virtually any other private or widely held investment entity), and generally including an investment fund that uses a professional management entity for any of its assets.

A non-financial foreign entity or NFFE is any foreign entity that is not an FFI.

A financial account with respect to any financial institution is a depository or custodial account, and also, somewhat surprisingly, any equity or debt interest in the financial institution other than interests which are regularly traded on an established securities market. The FATCA regulations generally exclude from the definition of financial account plain vanilla debt and equity securities of banks, brokerage firms, and insurance companies, even if not publicly traded.

A United States account generally is any financial account held by one or more specified United States persons or United States owned foreign entities. To avoid duplicative reporting, a United States account does not include an account in an FFI if it is held by another FFI that has a FATCA compliant agreement with the Service or if the holder otherwise is subject to information reporting requirements that the Treasury determines would make FATCA reporting duplicative. This exception may be very helpful to an offshore issuer in avoiding (or more accurately shifting to others) reporting burdens.

A recalcitrant account holder is any holder of a financial account in an FFI which, unless an exemption is available, fails to comply with reasonable requests to provide information needed for the FFI to determine if the account is a United States account or to meet its FATCA reporting requirements if it is a United States account (including waiving any foreign law that would prevent the FFI from reporting the information).

A specified United States person is any United States person with certain exceptions. The exceptions include, most significantly, corporations whose stock is regularly traded and their affiliates, governmental and charitable entities, banks and common trust funds, REITs, RICs and registered broker-dealers. There is no general exception for corporations that do not have regularly traded stock, which is not surprising given the purpose of the statute.

A United States owned foreign entity is any foreign entity with one or more substantial United States owners. A substantial United States owner is a specified United States person that has a required ownership interest. The required interest is generally a 10 per cent direct or indirect interest (by vote or value for a corporation and by profits or capital for a partnership). However, for an FFI that is an investment fund or a specified insurance company, any ownership interest is considered to be substantial. For a grantor trust, all specified United States persons who are treated as owners under the grantor trust rules are considered substantial owners. Thus, a
foreign trust that primarily holds receivables for investment (and accordingly is an investment fund FFI) and issues pass-through certificates would be required to treat all direct or indirect owners of any certificates that are specified United States persons as substantial United States owners.

An expanded affiliated group is a group of corporations (domestic or foreign) connected through more than 50 per cent ownership links, and also includes other entities controlled by members of such a group.

3. Foreign Financial Institutions

A withholding agent making withholdable payments to an FFI (other than to an FFI in a Model 1 or Model 2 Partner Country, or an FFI that is exempt from or treated as deemed compliant with FATCA) must withhold a 30 per cent tax unless the FFI meets the requirements of section 1471(b) described below.

An FFI meets the requirements of section 1471(b) (so that it can avoid withholding on payments it receives) if it registers with the Service pursuant to the procedures prescribed by the Service and agrees to comply with the terms of the FFI Agreement, which will incorporate the requirements set forth in the final FATCA regulations. Very generally, an FFI that enters into an FFI Agreement will be required to do the following:

- withhold on payments to recalcitrant account holders and nonparticipating FFIs;
- obtain information regarding its account holders to determine whether such holders are specified United States persons, recalcitrant account holders, or nonparticipating FFIs in accordance with the applicable due diligence procedures;
- report annually to the Service certain information with respect to United States accounts and accounts held by recalcitrant account holders, and where a foreign law would otherwise prevent the reporting of information with respect to an account, attempt to obtain a waiver of the law or close or transfer the account; and
- adopt a FATCA compliance programme under the authority of a responsible officer, who will be required to certify periodically to the Service on behalf of the FFI.

In the case of an FFI that is a qualified intermediary (QI), these requirements are in addition to those imposed under the QI agreement. Under certain circumstances, an FFI may be able to rely on its anti-money laundering rules to determine the status of its account holders.

The requirements of section 1471(b) are not met with respect to an FFI unless they are also met by each FFI that is a member of its expanded affiliated group. Thus, an FFI could go out of compliance if it owns or is owned more than 50 per cent by an FFI that does not comply with (or is not deemed compliant with) FATCA.

An FFI must agree to report the following information annually to the Service with respect to each United States account: the name, address, and TIN of each substantial United States owner of the beneficial account holder. NFFE reporting relates to particular payments. There is no requirement of annual reporting of account balances.

Section 1472 requires a withholding agent to withhold a 30 per cent tax from withholdable payments to a NFFE if the beneficial owner of the payment is a NFFE (either the payee or another NFFE) that is not exempt from withholding, unless the withholding agent receives (1) a certification that the beneficial owner does not have any substantial United States owners, or (2) the name, address, and TIN of each substantial United States owner of the beneficial owner. NFFE reporting relates to particular payments. There is no requirement of annual reporting of account balances.

An NFFE is not required to withhold on payments it makes (unless it is otherwise a withholding agent with respect to withholdable payments).

In addition, to avoid withholding, the withholding agent must not know or have reason to know that information it receives is incorrect and must report such information to the Service. Amounts that are withheld from payments to a NFFE are potentially refundable, if, in the case of an NFFE that is not entitled to the benefits of an income tax treaty with the United States, the required information is reported to the Service.

Certain NFFEs are exempted from these rules. These include (i) corporations the stock of which is regularly traded on an established securities market (and their affiliates), (ii) “active NFFEs” (entities whose gross income or assets are predominantly non-passive), (iii) certain holding companies, treasury centers and captive finance companies that are members of nonfinancial groups, (iv) nonfinancial start-up companies, (v) certain nonfinancial entities that are liquidating or emerging from reorganisation or bankruptcy, and (vi) non-profit organisations.
5. Grandfathered Obligations, Phase in of Obligations and Key Exemptions

The grandfathering date for withholding has been extended from obligations outstanding on 18 March 2012 (as provided in the Code) to those issued before 1 January 2014 and applies to all related collateral. (While a grandfathered obligation is not subject to withholding, it is generally not exempt from reporting.) An obligation will lose its grandfathered status if it is materially modified after 31 December 2013. Debt instruments generally are materially modified if they are treated as reissued under Section 1001 of the Code. In addition, the FATCA regulations provide that grandfathered obligations include (i) revolving and other lines of credit provided that the applicable agreement fixes the material terms (including a stated maturity date) prior to 1 January 2014, and (ii) derivatives entered into prior to 1 January 2014 (for this purpose entering into refers to entering into a confirmation, not merely a master agreement).

The FATCA regulations provide for a few additional categories of grandfathered obligations including certain “foreign passhru” obligations, certain obligations that produce “dividend equivalent” amounts under section 871(m), and certain collateral securing obligations that are, themselves, grandfathered.

Foreign Passhru Obligations. A grandfathered obligation will include any obligation that produces (or could produce) a passhru payment but cannot produce a withholdable payment, provided that the obligation is outstanding as of the date that is six months after promulgation of final regulations defining the term “foreign passhru payment”. This change applies to obligations that may give rise to foreign passhru payments, but not to withholdable payments. Effectively, the Service took steps to alleviate concerns over potential withholding on foreign passhru payments until it develops and announces a workable definition of the term.

Dividend Equivalent Obligations. A grandfathered obligation will include any instrument the payments on which are withholdable payments solely because payments on the instrument are treated as dividend equivalent payments under section 871(m) and the regulations thereunder, provided that the instrument is outstanding on the date that is six months after the date on which instruments of its type first become subject to such treatment. Very generally, under section 871(m), a dividend equivalent payment is treated as a US-source dividend and the term “dividend equivalent payment” is defined broadly to include payments in lieu of dividends (also known as substitute or manufactured dividends) in securities loans and repurchase agreements that are contingent upon, or determined by reference to, US-source dividends. Section 871(m) currently treats certain securities loans, repos, and notional principal contracts as making dividend equivalent payments (and, thus, withholdable payments). However, the section 871(m) regulations that will expand the scope of notional principal contracts and derivative financial contracts treated as making dividend equivalent payments are not yet effective. Thus, market participants do not know which derivatives will be subject to the expanded section 871(m). In order to give the benefits of grandfathering to contracts that become subject to section 871(m) after the general grandfathering period ends, the Service has linked the grandfathering date for instruments covered by the expanded category of applicable instruments to the publication of the final section 871(m) regulations. The delayed grandfathering date, however, does not otherwise affect the general grandfathering date of 31 December 2013 that is applicable to those contracts and transactions that are currently treated as making dividend equivalent payments.

Collateral. Collateral posted as security for a grandfathered obligation is also grandfathered. Where collateral secures both grandfathered and non-grandfathered obligations, a pro rata share of the collateral will be grandfathered.

Pre-existing Securitisation Vehicles. Because equity securities never benefit from grandfathering, a special category of deemed compliant FFIs, referred to as limited life debt investment vehicles (LLD), was established by the FATCA regulations to protect pre-existing securitisation vehicles. An LLD will be considered a deemed compliant FFI until 1 January 2017 (at which time it will need to enter into an FFI Agreement if it is not established in a Model 1 Partner Country). The key features of an LLD include that it be a collective investment vehicle formed pursuant to a trust indenture or similar fiduciary arrangement, it is an FFI solely because it is an investment entity that offers interests primarily to unrelated investors, it was in existence as of 31 December 2011, and its organisational documents require that the entity liquidate on, or prior to, a set date, and do not permit amendments to the organisational documents, including the trust indenture, without the agreement of all of the FFI’s investors. Further, the FFI must have been formed for the purpose of purchasing (and in fact purchase) specific types of indebtedness and holding those assets (subject to reinvestment only under prescribed circumstances) until the termination of the asset or the vehicle and all payments made to the investors of the FFI must be cleared through a certain clearing organisations, FATCA compliant FFIs, trustees or US financial institutions. The FFI’s trust indenture must only authorise the trustee to engage in specifically designated activities and no person can have the authority to fulfill the obligations of a participating FFI.

Read literally, few existing securitisation vehicles would qualify, but the rule was designed to benefit securitisation vehicles and it is likely that the Service will be willing to issue favorable rulings in appropriate contexts.

No Withholding on Short-Term Obligations. Payments of interest or original issue discount on debt obligations with a term of 183 days or less (such as commercial paper) are exempt from any withholding (but not necessarily reporting).

Delayed Withholding Date for Withholdable Payments on Certain Obligations. Withholding that would otherwise be required on payments to FFIs will be delayed until 1 January 2015 (from 1 January 2014) if the payer does not know or have reason to know that the payee is in fact an FFI.

Changes to Effective Dates for Compliance and Reporting. The regulations stagger the effective dates for FFIs to commence reporting on its account holders.

Below is a chart reprinted from Announcement 2012-42, administrative guidance that predated the FATCA regulations but which anticipated the FATCA regulations’ new timelines for withholding agents and financial institutions to complete due diligence and other requirements.
### Summary of Timing for Performing Due Diligence Procedures to Identify and Document Accounts

<table>
<thead>
<tr>
<th>Withholding Agents other than Participating FFIs and Deemed-Compliant FFIs</th>
<th>Withholding Agents that are Participating FFIs</th>
<th>Withholding Agents that are Registered Deemed-Compliant FFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Individual and Entity Accounts (Implementation of new account opening procedures)</td>
<td>Preexisting Accounts of Prima Facie FFIs (Date by which due diligence must be completed for all accounts)</td>
<td>Preexisting Accounts of Entities other than Prima Facie FFIs</td>
</tr>
<tr>
<td>Preexisting Accounts of High Value Accounts of Individuals</td>
<td>Preexisting Accounts of Individuals</td>
<td></td>
</tr>
<tr>
<td>By 30 June 2014</td>
<td>By 30 June 2014</td>
<td>By the later of 30 June 2014, or six months after the effective date of the FFI Agreement</td>
</tr>
<tr>
<td>By 31 December 2015</td>
<td>By the later of 31 December 2015, or two years after the effective date of the FFI Agreement</td>
<td>By the later of 31 December 2015, or two years after the effective date of the FFI Agreement</td>
</tr>
<tr>
<td>Not applicable</td>
<td>Not applicable</td>
<td>Not applicable</td>
</tr>
</tbody>
</table>

The FATCA regulations also ease the procedures for identifying pre-existing US account holders. In general, FFIs can rely on electronic document reviews for accounts up to $1 million and for accounts with a balance in excess of $1 million, a review of existing paper documents is required only if the electronic search fails to yield sufficient information. Further, an FFI may not need to update their customer verification procedures with respect to new accounts. Finally, FFIs that adhere to the diligence guidelines outlined in the FATCA regulations and that comply with the withholding requirements of section 1471(b) and any other requirements in an FFI Agreement will be treated as in compliance with their withholding and reporting obligations and will not be held to a strict liability standard.

**Exempt FFIs.** Certain categories of FFIs will not be required to enter into an FFI Agreement, although such FFIs, among other stringent requirements, will need to have strict rules in place that prohibit accounts held by US persons or certain non-compliant FFIs. Such deemed compliant entities include certain regulated investment funds (referred to in the proposed regulations as “qualified collective investment vehicles” and “restricted funds”). A significant requirement of qualified collective investment vehicle status is a requirement that each holder of debt interests in the fund in excess of $50,000 or any equity interest in the fund is, among others, a participating FFI.

The requirements to qualify as a restricted fund include the following: interests in the fund are distributed only through, among others, participating FFIs, the distribution agreements prohibit sales of debt and equity interests to, among others, specified United States persons and non-participating FFIs, and all marketing materials indicate that sales to, among others, specified United States persons and non-participating FFIs is prohibited. No similar rule is available to non-regulated investment funds or securitisation vehicles, even if their constituent documents contain similar transfer restrictions.

**Nonfinancial payments.** Ordinary payments such as wages, leases, licences, and interest on accounts payable for goods and services are excluded from the scope of FATCA.

**Limits definition of financial account.** Excluded from both withholding and reporting are plain vanilla debt and equity securities issued by banks, brokerage firms, investment managers, and insurance companies, even if such interests are not regularly traded on an established securities market. This rule does not apply to other FFIs, including investment funds and securitisation vehicles.

### 6. Expanded Affiliate Rule

An FFI will be unable to enter into an FFI Agreement if any of its FFI affiliates do not enter into its own FFI Agreement. Accordingly, FFIs will need to determine whether the composition of its equity owners may cause other FFIs that are not in compliance with FATCA to be treated as an affiliated FFI. Recognising that some jurisdictions have in place laws that prohibit an FFI’s compliance with certain of FATCA’s requirements, the FATCA regulations provide a two-year transition, until 1 January 2016 (which is permanent in the case of FFIs in countries with intergovernmental agreements in place), for the full implementation of this requirement. During this transitional period, an FFI affiliate in a jurisdiction that prohibits the reporting or withholding required by FATCA will not prevent other FFIs within the same expanded affiliated group from entering into an FFI Agreement, provided that the FFI in the restrictive jurisdiction agrees to perform due diligence to identify its US accounts, maintain certain records, and meet certain other requirements. This transition period will not apply, however, to affiliate FFIs that are not prohibited by law from complying with an FFI Agreement.

### 7. Use of US Withholding Agents as Blockers

The Treasury and the Service have indicated that they are aware of the potential for using US withholding agents as blockers for foreign passthru payments made to nonparticipating FFIs. The potential arises because US withholding agents are required to withhold only with respect to withholdable payments while a participating FFI (generally, an FFI that has entered into an FFI Agreement or is otherwise FATCA compliant) may be required to withhold on all payments. In light of the potential for abuse, the Treasury and the Service have announced that they are assessing various options to address this issue, including expanding the scope...
of payments that US withholding agent must withhold on, or requiring FFIs to withhold on passthru payments made to US withholding agents acting as intermediaries. To date, no specific rule has been announced, although the technical rules of who is treated as a payee may limit some of the more egregious schemes.

8. Intergovernmental Agreements

As discussed above, the United States has entered into, and expects to enter into many more, IGAs based on the Model IGAs. When the Model 1 IGA was originally released, the accompanying Treasury announcement indicated that agreements based on the Model 1 IGA were expected to be entered with, among others, France, Germany, Italy, Spain, and the United Kingdom although the United States was willing to enter into agreements with other countries as well. The United States and the United Kingdom signed the first intergovernmental agreement, based on the reciprocal version of the Model 1 IGA on 12 September 2012. Since then, intergovernmental agreements based on the Model 1 IGA have been entered into with a number of other countries. The Model 1 IGA is discussed further in section E.8.(i), below.

The Model 2 IGA offers different parameters than those of the Model 1 IGA. The most significant distinguishing feature of the Model 2 IGA is that a Model 2 FFI will be permitted and required by the Model 2 Partner Country’s domestic law to register with the Service by 1 January 2014 and to comply with the requirements of an FFI agreement. The Model 2 Agreement is discussed further in section E.8.(ii), below.

(i) Model 1 IGA. A Model 1 FFI will not be required to enter into an FFI agreement with the Service. Instead, a Model 1 FFI will be required to comply with the reporting, withholding, and other obligations delineated in the applicable intergovernmental agreement (each such agreement, a Model 1 Partner FATCA Agreement) that a Model 1 Partner Country and the United States have executed. In addition, it is expected that the FATCA compliance requirements will be mandated under each Model 1 Partner Country’s internal laws, rather than pursuant to an FFI Agreement, which is a voluntary agreement entered into with the Service. This requirement to comply with a Model 1 Partner Country’s FATCA-related rules should resolve any ambiguity as to whether any reporting and withholding undertaken by a Model 1 FFI is in compliance with the laws of the Model 1 Partner Country (including those dealing with confidentiality) and also whether any withholding is required “pursuant to law”, as that term is used in transactional documents. Market participants have been concerned that the US statutory requirement to withhold applies only to US source FDAP income and gross proceeds from the disposition of certain US assets, and that withholding on any other amounts pursuant to a voluntary agreement entered into with the Service may conflict with the terms of transactional documents, which traditionally permit withholding only to the extent “required by law”. If, however, Partner Countries adopt their own laws analogous to FATCA in order to further the implementation of their Model 1 Partner FATCA Agreements, there would be no dispute as to whether a Model 1 FFI’s obligations to withhold in accordance with the applicable Model 1 Partner FATCA Agreement are required by law.

Model 1 FFIs also will be subject to different and in some cases less burdensome, reporting and withholding requirements than FFIs resident in countries which do not enter into IGAs with the United States. However, Model 1 FFIs generally will still be required to conduct due diligence to identify their direct and indirect US account holders and to report on those accounts to the Model 1 Partner Country. In general, the diligence rules will be more closely aligned to existing practices. Further, Model 1 FFIs will be required to collect certain information (and perhaps in the future withhold on payments made) with respect to accounts held by certain nonparticipating FFIs. Model 1 FFIs will not, however, be required to withhold on payments to, or close accounts held by, non-FFI account holders that fail to comply with requests for identifying information, provided that the Model 1 FFIs report on such accounts to their own governments. Accordingly, Model 1 FFIs still face material and significant compliance requirements in respect of FATCA. In addition, a Model 1 FFI that fails to meet the reporting, withholding, or other requirements of the relevant Model 1 Partner FATCA Agreement will be designated as a nonparticipating FFI, and, therefore, be subject to FATCA withholding.

Reciprocity may be required for US Financial Institutions. The reciprocal version of the Model 1 IGA requires the United States to pursue legislative and administrative actions to achieve reciprocal and automatic exchanges of information between the United States and a Model 1 Partner Country with respect to accounts maintained by US financial institutions. Although the possibility of reciprocal reporting by US financial institutions has always been contemplated, it appears that US financial institutions should anticipate that they may become subject to increased reporting obligations as a result of such reciprocal obligations.

Requirement to Gather and Report Information. Although Model 1 FFIs will not enter into FFI agreements with the Service, they still will be required to gather and report account information about their direct and certain indirect US holders to the applicable Model 1 Partner Country, which will then transmit such information to the United States. However, the reporting and due diligence requirements imposed on Model 1 FFIs will be somewhat modified under a Model 1 Partner Agreement.

Modified Withholding Obligations. The Model 1 IGA modifies some withholding obligations. Model 1 FFIs are not required to withhold on or terminate accounts held by recalcitrant holders. Further, Model 1 FFIs are not required to withhold on payments of US-source passive income made to non-participating FFIs, provided that the Model 1 FFI provides its immediate payor the information required for the payor to perform the necessary withholding and reporting. However, Model 1 FFIs that are acting as qualified intermediaries and that have assumed US withholding and reporting responsibilities with respect to an asset will be required to withhold on payments on such asset.

The Model 1 IGA delays withholding for non-US source income and gross proceeds until an agreement is reached between the governments at some time in the future. It is unclear if a future agreement will modify, and if so, to what extent, the withholding obligations of Model 1 FFIs on payments of such other amounts to non-participating FFIs. This approach parallels the general approach of the FATCA regulations with respect to foreign source passthru payments.

Modified Affiliate Rule. In contrast to the rule for FFIs of non-Partner Countries, Model 1 FFIs with affiliates (including branches) in jurisdictions that are prohibited from complying with FATCA under local law will not be prevented from being treated as FATCA compliant, subject to certain anti-abuse rules. FFIs in non-Partner Countries can rely on a similar FATCA rule only on a transitional basis. It is worth noting that while the existence of an affiliate that is not able to comply with FATCA due to legal prohibitions will not prevent a Model 1 FFI from complying with FATCA, that protection will not extend to other affiliated FFIs that are not themselves Model 1 FFIs.

Securitisation vehicles that are in a Model 1 Partner Country may not be able to benefit from this rule since the exemption generally
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US Taxation of Non-US Investors in Securitisation Transactions

requires cooperation from its noncompliant affiliates to ensure that US persons do not hold accounts with such noncompliant affiliates and securitisation vehicles generally do not have any control over its noncompliant affiliates to ensure such procedures.

**Modified Exception for Bank Debt and Equity.** The exception for plain vanilla debt and equity of banks, investment managers, insurance companies and custodians is broader under the Model 1 IGA than under the FATCA regulations. Generally, under the latter, debt or equity of such institutions will not be subject to FATCA reporting and withholding unless the value of the debt or equity is determined by reference to US assets or the interest is issued with a principal purpose of avoiding the requirements of FATCA. The Model 1 IGA, however, requires that both conditions be met (i.e., references US assets and issued with a bad purpose) in order to fall outside the exception. This expanded exception will ease somewhat the FATCA-related requirements for many structured notes issued by financing subsidiaries of banks. As with the similar rule in the FATCA regulations, the exception prevents straight debt or equity of certain FFIs from being “accounts” to which FATCA reporting applies. This exception does not prevent such debt or equity from being treated as part of the assets of a custodial account in which it is held and, thus, does not protect it from information reporting (and where appropriate withholding) as an asset of a custodial account.

**Non-reporting FFIs and Products.** Annex II of the Model 1 IGA is reserved for a list of (i) categories of exempt beneficial owners or deemed-compliant FFIs of the Model 1 Partner Country, and (ii) categories of financial accounts and products issued in the Model 1 Partner Country that will be exempted from reporting under the agreement, determined on a country-by-country basis in consultation with the government of the Model 1 Partner Country.

**Beneficial Owners.** The Model 1 IGA currently provides that a person, other than a financial institution, holding a financial account for the benefit or account of another person as agent, custodian, nominee, signatory, investment adviser, or intermediary is not treated as holding the account for purposes of the IGA, and that the other person is treated as holding the account. (The Model 1 IGA as originally released did not address the treatment of beneficial owners.)

**Executed Model 1 IGAs.** Although the individual intergovernmental agreements patterned on the Model 1 IGA that have been entered into and made available as of this article have varied in minor ways from the Model 1 IGA, each has been substantially the same as the Model 1 IGA in all respects material to the securitisation market.

(ii) Model 2 IGA. The Model 2 IGA is similar to the Model 1 IGA except that instead of reporting to its home country revenue service, a Model 2 FFI will be permitted and required by its home country law “to register with the IRS by 1 January 2014 and comply with the requirements of an FFI agreement . . . ”.

**Account Holder Consent.** Because an agreement patterned on the Model 2 IGA requires direct reporting of information to the Service, the Model 2 IGA requires each Model 2 FFI as a condition of opening a new account to obtain consent of each holder of a new account that is identified as a US account to report information to the Service. A similar requirement applies to new accounts of nonparticipating FFIs with respect to which the Model 2 FFI expects to pay a “foreign reportable payment” (a payment of FDAP income that would be a withholdable payment if it were paid from sources within the United States). In addition, a Model 2 FFI must request consent of pre-existing account holders to report to the Service. In order to encourage pre-existing account holders to consent, each Model 2 FFI must also inform pre-existing account holders that even if an account holder does not consent, the Service can request and obtain information about the account from the Model 2 Partner Country’s revenue service.

**Reciprocity.** The Model 2 Agreement does not provide for reciprocity. It does, however, indicate that the United States is willing to negotiate a reciprocal obligation subject to a determination that the standards of confidentiality and other prerequisites for cooperation are fulfilled.

**Endnote**

1. Except as otherwise noted, all section references are to the US Internal Revenue Code of 1986, and references to regulations are to the Treasury Regulations promulgated thereunder. This chapter is current through 15 February 2013. For more updated information on the topic, please see the updates to chapter 12 of James M. Peaslee and David Z. Nirenberg, FEDERAL INCOME TAXATION OF SECURITIZATION TRANSACTIONS AND RELATED TOPICS (Frank J. Fabozzi Associates. 2011), available free of charge at the website for the book: www.securitizationtax.com.
David Z. Nirenberg is a partner in the international finance department in New York. He covers the tax aspects of securitisations, structured products and finance, derivative products and investment funds and has played a significant role in the structuring of a wide variety of innovative financial products in both domestic and cross-border markets.


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Chapter 4

Debt Trading: A Practical Guide for Buyers and Sellers

Berwin Leighton Paisner LLP

The continued constraints on the securitisation market have meant that financial institutions have had to look to different exit strategies for loans and other assets on their balance sheets. In addition, financial institutions are under increasing pressure to delever their balance sheets. This is the result of three main factors: (i) increased regulatory capital demands which are being introduced in phases under Basel III; (ii) the need to comply with European Commission (EC) State Aid requirements for certain financial institutions (such as Royal Bank of Scotland (RBS) and Lloyds Banking Group); and (iii) impairment charges as a result of the deterioration of some portfolios.

A key issue for European banks is the exposure to loans originated pre-crisis which are thinly priced and the increase in the cost of interbank lending which makes wholesale funding increasingly expensive. This is particularly problematic for infrastructure and project finance debt which is generally long dated and the pricing pre-crisis was particularly tight.

Many holders of debt, particularly banks with residential and commercial mortgage portfolios that were not securitised and closed-end funds that purchased debt, have either been active sellers of their debt positions or have run processes to solicit bids in an attempt to sell. In addition, there has been a trend towards banks exiting non-core businesses. There has been a concentration of sales of commercial real estate loan portfolios, driven by the factors mentioned earlier and a significant appetite on the buy-side from the funds sector. Also the level of defaults results in the need for more specialised asset management to maximise recoveries on these assets and this skill set is strong in the funds sector.

Over the past 24 months, a number of financial institutions have successfully closed high profile debt sales in the UK and throughout Europe. Transactions of note include the successful and well-managed series of loan auctions by Lloyds Banking Group (including Projects Royal, Prince, Harrogate, Forth, Pittlane, Pittsborough and Chamonix). Project Isobel was the sale by RBS of £1.4bn non-performing UK commercial real estate (CRE) debt in a structured exit, involving Blackstone. Another transaction of note was the acquisition in 2012 by Lonestar of circa £1.4bn of notes in the Lehman Excalibur collateral debt obligation (CDO). Potential loan portfolio sales by Commerzbank, including a performing and sub-performing €5bn UK CRE loan book of Hypothenkenbank are also in the pipeline along with Lloyds Project Wagner. Although there has been a lot of activity in the commercial real estate sector, there have also been portfolio sales in the retail sector, as well as SME, corporate and infrastructure debt sales. The highest profile deal that failed to close was AIB’s Project Pivot where the portfolio shrunk from £397m to £100m and a floor to the sale price was stipulated.

In the Irish market, as a result of Irish bank restructuring, circa €34bn of non-core assets have been earmarked for disposal by way of asset sales by institutions, including Allied Irish Banks (AIB), Bank of Ireland, Irish Life and Permanent and Irish Bank Resolution Corporation (IBRC). In addition, the National Asset Management Agency (NAMA) has a loan portfolio disposal strategy for its portfolios located in Ireland, the UK, the US and Europe. We have already seen activity from NAMA (such as Project Saturn and Project Chrome) and AIB (Project Kildare).

In addition to the bank sector, the CMBS sector provides significant opportunities for the acquisition of debt and underlying assets as the maturity date of the loans passes and the maturity date of notes approaches, thereby limiting the ability to extend the loans. Opera Finance (Uni-Invest), a securitisation collateralised by Dutch commercial real estate, was the first European CMBS to default at note level (in February 2012) after a failed attempt to sell the underlying property companies. TPG and Patron Capital, advised by Berwin Leighton Paisner, proposed an innovative structure to the Class A Noteholders (who controlled the enforcement process) to buy out the debt from the securitisation. The structure involved paying down 40 per cent of the principal amount of the Class A Noteholders while rolling the remaining 60 per cent debt owed to the Class A Noteholders into a new deal secured on the same underlying properties for a term of five years. All other creditors in the transaction structure were wiped out. TPG and Patron Capital also acquired the equity in the underlying borrower.

The execution of debt sales, whether by balance sheet lenders or within the framework of structured finance transactions, such as Uni-Invest, requires a clearly defined process and data with integrity. Buyers have tolerance thresholds, both in terms of the quality of diligence information and discount to face value, which has been illustrated by some unsuccessful divestment projects which have come to market.

In this chapter, we consider some of the key issues arising from debt portfolio sales, from the perspective of sellers and purchasers of debt and third party financiers funding the purchase, based on our recent experience of advising different participants in the market.

The Auction Process

The process for soliciting interest and bids for loan sales takes many forms with varying degrees of formality. Where large portfolios are being sold, typically, a formal auction process will be run. While the specific process will vary, typically there are two phases to the auction process: Phase One, where an initial round of bidders are invited to perform initial due diligence for the purposes of submitting an indicative price or range of prices; and Phase Two,
where a small number of bidders progress to more detailed due diligence and finalisation of pricing. During Phase Two, bidders are also typically provided with pro forma sale and purchase documentation and provide a mark-up of the documents with any comments/amendments when they submit their final bid. The overall intention of the seller is to maintain competitive pressure throughout the sale process and prevent the situation where a buyer can renegotiate the price at the last minute.

The process tends to take a different form where the auction is in the context of a structured finance transaction as distinct from an outright sale by a balance sheet lender. In a structured finance transaction, where the sale is at loan level, the “seller” will typically be the special servicer (acting as agent of the issuer), whereas if the sale is of the loan (i.e. as a result of a default at the note level), the sale will be by the security trustee for the noteholders acting at the direction of the holders of the most senior class of notes. In both situations, there are overriding express or implied fiduciary duties of the seller which can influence aspects of the auction process.

### Data Room Content and Rules

The starting point for an auction process is assembling the information by reference to which bidders will undertake due diligence. The information is collated in a “data room” which is typically a website to which bidders will be given online access. Usually, the bidders in Phase One will be given limited access to the data room and the Phase Two bidders will be given full access.

To assist the seller and its advisors in managing the auction process, there will be a set of rules by reference to which access to information is provided and which set out the process and procedures for the auction. If a bidder breaches the rules, it can result in exclusion from the auction process and, potentially, contractual liability.

The data room will usually comprise a data tape with loan and asset level data, legal documentation related to the loans (loan agreements, amendment agreements, guarantees, security documents, legal opinions etc.). An up-to-date complete and accurate data tape is critical to the process, because a significant part of the pricing analysis undertaken by buyers is based on this data. Any errors in the data tape are likely to undermine bidders’ confidence in pricing and could lead to price renegotiation or bidders withdrawing from the process.

It can take time to compile the data room, particularly because some sellers have incomplete/missing documentation. An important aspect of the data room is formatting and indexing the files in which the loan level information is held in a clear and coherent “user-friendly” manner. Purchasers will be reluctant to engage in the due diligence process if they enter the data room and are confronted by hundreds of PDF documents which are not clearly identified and they have to engage in a voyage of discovery as to the identity and relevance of each document.

As an initial step in preparing the data room, the seller’s legal advisers will need to carefully review confidentiality provisions of loan agreements and other information (such as third party reports) and ensure that any consents to disclosure are obtained. Non-disclosure and confidentiality agreements will typically be signed with bidders as a precondition to access to the data room and are thus a preliminary part of the auction process.

Where the sale is related, either directly or indirectly, to listed securities, the data room may be divided between information that is in the public domain and information that is not in the public domain. Information that is not in the public domain could constitute non-public price sensitive information. Access to such information would prevent the bidder buying or selling the securities. In these circumstances, there needs to be a clear process for cleansing such information.

### Due Diligence

The scope of the due diligence varies according to the type of assets that are being purchased (whole loans, A/B split loans, performing/non-performing notes, X notes, etc.), the basis of the pricing decision, scope of representations and warranties being provided by the seller, the amount of data captured by the seller and the integrity of the seller’s records and systems.

By way of example, the due diligence for a non-performing portfolio may differ from the due diligence for a performing portfolio. The due diligence for the former focusing mainly on the value of the collateral and the security package in the context of the buyer’s enforcement strategy rather than any detailed consideration of the terms of the loan agreement.

Some of the key areas for consideration as part of the due diligence processes are:

1. **Data Tape**: The verification of the information captured on the data tape back to the source is a critical part of the due diligence process. Particularly in the case of granular assets, such as residential mortgage portfolios and consumer loans, where portfolio based valuation and pricing will be used. For example, the interest data generated will be based on algorithms that calculate the interest to be applied to the loan balance; this needs to be verified to ensure that the calculations are in accordance with the loan documents.

2. **Collateral**: The underlying collateral is key to the value of the assets being acquired. For real estate collateral, due diligence would include title/ownership verification, zoning permissions, assessment of the physical condition, including machinery and equipment, title ownership, leases and rent roll.

3. **Origination Due Diligence**: Original appraisal reports and other commercial and legal underwriting due diligence undertaken at the time of the origination of the loan may be made available, although the value of some elements of this will depend on the time elapsed since origination. Disclosure of these types of reports may require adherence to non-reliance letters. It is unlikely that reliance can be placed on these and disclosure may also be restricted.

4. **Security**: A detailed security review will be undertaken to ensure appropriate security exists in respect of the relevant assets and such security is binding and enforceable. In the context of non-performing loans, the type of security will influence the work-out strategies. The security needs to be reviewed by legal counsel to verify its integrity and assess the range of enforcement methods, the time and cost implications for any enforcement to determine the appropriate enforcement strategy.

5. **Regulatory Compliance**: Some classes of assets are heavily regulated both with respect to the terms upon which they are originated and the way in which enforcement and collections are undertaken. This is particularly relevant in the context of consumer assets (residential mortgages, second liens, small unsecured consumer loans, point of sale credit and credit cards). Non-compliance with the relevant regulatory requirements can lead to the relevant loan being unenforceable as well as regulatory sanctions being applied to the owner of the debt.

6. **Waterfalls**: A careful review of pre- and post-enforcement cash flows and the accounts through which revenue and principal receipts pass is critical to understanding potential
recovery. In the current interest rate environment, there are many out of the money swaps which are secured and rank equally with the debt, which can materially dilute recovery in enforcement situations. Of particular focus is the extent to which there is scope for leakage by way of fees and expenses to both borrower group companies and third parties.

7. Enforcement and Insolvency Regimes: A clear understanding of the enforcement process (including time period and costs of enforcement) applicable in each country where any secured asset is located is important. Many countries have court based auction processes which tend to be lengthy and relatively expensive. This needs to be taken into account in assessing the expected returns to any purchaser. Germany, in particular, has potentially lengthy court-based insolvency proceedings which directors may initiate to the detriment of creditors. In contrast, the UK has a simple and creditor-friendly enforcement regime.

8. Counterparty Credit Risk: Transactions may have multiple layers of counterparty credit risk, as illustrated by the insolvency of Lehman Brothers. Much emphasis was placed on reviewing the performance of collateral on the Lehman securitisation programmes (such as Eurosail and Windermere), but when Lehman became insolvent, the primary issue for the securitisations and investors in lower tranches of securitised debt was the termination of the currency swaps that Lehman had entered into with the securitisation vehicles. Other counterparty risks include tenants, bank accounts, bank liquidity facilities and undrawn commitment on facilities, property managers and the agent. The insolvency of Lehman Brothers highlights that assumptions regarding the solvency of any counterparty need to be carefully examined.

9. Counterparty Performance Risk: Many asset pools have counterparties performing functions that are integral to the ongoing performance of the assets and debt (such as collection agents, managing agents, servicers, etc.). The ability of these parties to terminate their contracts on enforcement (insolvency is a typical termination right) and the ability for a creditor to step in needs to be assessed. Also, the quality and expertise of individuals, investment in training and quality of systems and data needs to be carefully reviewed and underwritten. In particular, when dealing with granular portfolios (such as residential mortgages and credit cards) the operating software systems need to be assessed for compatibility with the purchaser’s systems and ownership of the source code and object code verified, together with a review of any related software licences.

10. Intercreditor Rights: A careful understanding of the terms of any intercreditor agreement is important when buying a position in any debt that has been tranched through intercreditor arrangements. Any restructuring of the debt is likely to require the consent of parties to the intercreditor (and the beneficiaries under any security trust arrangements). The circumstances when cash flows are switched (cash trap and/or full cash sweep) are often embedded in the terms of intercreditor arrangements. Typically, swaps are correlated to each tranche of debt and thus, where buying mezzanine or junior debt, the terms of any senior ranking swaps, potential volatility and the timing of termination become very relevant.

11. Loan Agreement: The terms of the loan agreement and related documents are fundamental to the assessment of the asset being acquired. Specifically, when cash flows are blocked from flowing to equity, the operation of financial and other covenants and associated grace and cure periods all need to be fully understood. A point that needs to be checked carefully is the distinction between an “event of default” and “acceleration”. An event of default gives rise to the right to demand immediate repayment of the outstanding debt and does not necessarily automatically trigger an obligation to repay. In some loan agreements, cash trap and cash sweep provisions are triggered by an event of default and, in others, by acceleration. Many deals closed at the height of the cycle were less than perfectly documented and thus a careful review of the terms of the documents is essential.

12. Voting Rights: If a buyer is not acquiring the full capital structure, a clear understanding of voting rights needs to be understood. In loan agreements and bond transactions, certain matters may require an ordinary majority (over 50 per cent), some require an extraordinary majority (66⅔ per cent or 75 per cent) and some matters may require unanimity. The voting rights need to be understood across the entire capital structure. The terms of the debt need to be reviewed in conjunction with any intercreditor agreements that may modify the voting position between the lenders. With respect to voting rights in bond transactions and noteholder meetings, it is essential to review the trust deed rather than rely on the terms and conditions that are reproduced in the prospectus, as experience has shown that reliance cannot always be placed on the completeness of the summaries of documentation or loans in the prospectus. There is a concern as to the extent to which underlying documents can be regarded as “in the public domain” and whether this triggers insider trading concerns. Therefore, legal advice on this is necessary.

The level of legal due diligence undertaken by the seller’s legal counsel varies, however, at a minimum, the seller’s legal counsel will need to check certain key items in the loan and security documentation for the purposes of the sale, including confidentiality provisions and assignability. When advising sellers, we would usually work with them at an early stage in the process to identify whether any issues with the assets which could impact on the sale process and may have a material impact on pricing, so that they can be highlighted to buyers or separately addressed at an early stage to avoid nasty surprises arising which are detrimental to the sale process.

Buyers will also typically undertake their own legal due diligence. Although some asset warranties are usually provided by the seller, depending on the transaction, the scope of these may be relatively limited and it is standard for there to be limitations on the seller’s liability (see further below). The level of diligence undertaken by the buyer therefore depends to some extent on the seller warranty package and recourse, but also on the nature of the portfolio and enforcement strategy and may also be partially driven by the requirements of any financiers who will be funding the acquisition.

**Loan Purchase Documentation**

The documentation for the acquisition of loans or securities varies from deal to deal, depending on the type of asset being sold and the commercial objectives of the buyer and seller. Some of the key provisions of sale and purchase documents are:

1. **Assets**: If loans or securities are being sold, then the core assets subject to the sale are the rights under the loan documentation (or the terms and conditions of the notes) and the security related to the debt and recourse under that security (ultimately the collateral that is subject to the security). The security may include the mortgage or other fixed security on the main collateral (residential or commercial real estate, projects and concession agreements associated with projects, ships, aircraft, etc.), bank accounts, share charges, guarantees, assignments of insurance and recourse against advisers engaged in underwriting (valuers, lawyers, etc.). Where the debt is structured as a syndicated loan or a note, then the security will typically be held by a trustee on trust for the benefit of the creditors under the loan or note issue. From a legal perspective, additional complexity arises where the security for the asset is in the form of “all moneys charges” which secures all the debt of the original lender to the
borrower from time to time, particularly where the seller is selling some, but not all, of the debt owed by the borrower. In such circumstances, the seller may use a sub-participation, swap or trust arrangement to pass on the benefit of the debt, and thereby retain the benefit of the all money security with respect to the debt which it is retaining.

2. Warranties: The buyer will seek warranties related to the seller and the underlying assets being acquired. With respect to warranties related to the seller, these will cover usual matters such as due incorporation and its ability to enter into documentation which is legal, valid and binding. Additionally, in light of the downfall of Lehman Brothers, even when buying from large well-established institutions, representations and due diligence as to solvency are essential. With respect to the assets, the approach will depend on the basis upon which the transaction is undertaken. As mentioned above, losses are undertaken with very limited warranties and buyers are given full access to data and expected to undertake detailed due diligence. On other transactions, buyers are provided with less data and sellers provide comprehensive warranties. The scope of warranties and level of due diligence undertaken may impact upon the purchase price. Where pricing is driven off key data in the data tape, warranties as to the accuracy of specified portfolio fields of data together with appropriate due diligence can be critical. Where dealing with granular assets, such as residential mortgage loans, the risk of systemic error should be considered and addressed, either through warranties or by way of due diligence. In our experience, the negotiation of warranties and limitations with respect to breach can be protracted. As a general approach, a buyer should request, and a seller should expect to give, certain standard representations and warranties. These include that the account balances and key financial information is correct, the debt constitutes a legally binding obligation and the existence and validity of underlying security. Sellers will usually need to undertake a verification exercise to ensure the warranties they give are true and that there is no retained risk arising as a consequence of giving such warranties.

3. Limitations on Recourse for Breaches of Warranties: The right to bring a claim for breach of warranty will be restricted by a series of specified limitations. These will include the time period within which a claim must be made (e.g. 12 months to 36 months), maximum liability (typically a percentage of the purchase price) and minimum amount of the claim (e.g. exclusion for small claims). The buyer will be expected to take proper steps to mitigate any loss and the seller may have the right to take over any loss mitigation strategy. Most importantly, claims will be barred for disclosures made in the disclosure letter provided with respect to the representations and warranties. The disclosure letter is defining the potential scope of liability and the basis of disclosure should be clearly understood prior to embarking on the sale process.

4. Remedy for Breach: The remedy for breach is typically a form of monetary claim based on damages or an indemnity. The concept of damages as a remedy is in principal simple and the scope of contractual damages is a tried and tested area of English law. The main issue in portfolio sales in using damages as a remedy is whether the measure is by reference to an individual asset or the portfolio as a whole. From a seller’s perspective, damages should be defined as the loss (or reduction in value) in the portfolio as a whole arising from the specific breach. From the buyer’s perspective, they will seek to apply the test on an asset by asset basis. A buyer’s remedy may include a put option whereby the buyer can put the asset back on the seller at the purchase price (or by reference to an agreed formula) if there is a breach. Put options are “clean”, but not consistent with the seller’s (usual) objective of exiting a position permanently and are therefore rarely seen in current transactions. However, call options are now often included, so that if a breach of warranty claim is initiated by a buyer, the seller has the option to repurchase the relevant asset rather than pay a claim based on damages (or indemnity).

Financing

There are two main forms of financing: vendor financing and third party financing. Vendor financing is made available to purchasers of debt by the seller of the debt. From the start of the financial crisis until around 2011 there was very limited third party financing and thus transactions were financed either with vendor financing or entirely with equity. There were notable exceptions, principally where purchasers were major institutions with strong banking relationships. In the current market, there are several financial institutions who will provide financing to purchasers. Typically the finance is in the region of 50 per cent to 60 per cent of the acquisition costs. There have been higher advance rates, but this comes at a cost. The recent Uni-Invest transaction was a good example of a new form of vendor financing. The securitisation had defaulted and the class A Noteholders became the controlling party for enforcement purposes. The class A Noteholders accepted a proposal from TPG and Patron Capital whereby the purchase price paid was 40 per cent cash and 60 per cent debt in a new funding arrangement secured on the assets. This financing enhanced the ability to sell the assets at a price that in aggregate was equal to the balance outstanding on the class A Notes. More generally, both the vendor and the purchaser can reap benefits from the vendor providing a percentage of the purchase price. Advantages include widening both parties’ potential customer base and relationships; lowering the cost of obtaining credit facilities in comparison to usual sources with potentially lower all-in funding costs, and reducing the acquisition costs by sharing them between both parties. Vendor financing has also been secured with limited recourse to the particular assets concerned rather than on the purchaser’s own assets and equity.

There are, however, some disadvantages. The granting of credit will result in risk with respect to the asset being retained on balance sheet and consequential associated regulatory capital requirements (which become even less attractive under Basel III). The vendor will still incur the ongoing costs of managing and accessing the assets within the portfolio whilst it will still bear some of the risk involved if, for example, the loans go into default or the borrower becomes insolvent. In view of the current poor credit market conditions, many purchasers may choose not to take the asset as well as counterparty risk no matter how attractive the terms of the vendor financing may be.

Vendor financing can be structured in many ways. Examples of vendor financing include equity but with a fixed return and a payment-in-kind (PIK) note which ranks behind bank debt with the intention of it being repaid when the asset is sold and the structure is unwound, but will be repaid ahead of equity. Parties are also prepared to stagger any financing, such that any vendor financing may amortise towards the maturity of the loans or be subordinated to other positions in the capital structure.

Key considerations for third parties providing finance are:

Exit strategy: the financier may need the transaction to comply with certain requirements to facilitate the desired exit (e.g., syndication, securitisation or other means).

Article 122a of the Capital Requirements Directive: the financier will need to be comfortable that the financing is not caught by the requirements of Article 122a of the Capital Requirements Directive or that it complies with the requirements of Article 122a.
Servicing and control: the financier will need to be comfortable with the business plan for the assets being acquired and will want a level of control over actions to be taken with respect to the assets. In addition, the financier will usually have the right to “step in” and control the servicing of the assets in certain circumstances.

**Flexibility and Innovation**

The structure of the acquisition and the holding of debt securities/loans going forward will be driven by those sellers that are able and want to execute a clean break (and can afford to take any losses resulting from the sale price being lower than book value) and those that either do not want to or are unable to undertake a clean sale and thus retain a participation in the future cash flows derived from the assets.

Within this context, broadly, two themes or types of transaction are developing in the market – straight sales and “structured sales”. A straight sale is simply an arm’s length sale to a third party with complete risk transfer with respect to the assets and typically very limited warranties and no vendor financing. Structured sales involve an arrangement where the seller retains some economic interest in the performance of the collateral that is “sold” and may not constitute a significant risk transfer. The retained interest may be structured through deferred consideration mechanisms or a promote based on exit values or through a more complex joint venture arrangement with a retained position in the entity acquiring the assets.

The objectives of the “structured sale” vary, but typically include some of the following: retention of upside with a cap on downside risk, bridging the gap between the book value and market value (through instruments such as deferred consideration); creating liquidity through the use of forms of “collective investment” arrangements; creating an alignment of interest with an asset manager and equity; and partial balance sheet “de-recognition”. European banks are increasingly looking at innovative solutions that include these types of features in the context of overall asset (balance sheet) reduction strategies.

An example of such innovation is Project Isobel. Isobel was a sale by RBS of a portfolio of UK corporate real estate and operating company/property company loans to a newly created fund vehicle. RBS took a majority stake, and Blackstone a minority stake in the investment vehicle which was established under the UK corporate securitisation tax regime. Blackstone was also appointed as asset manager, partly reflecting its expertise in the operating business sectors. The transaction was designed to maximise recoveries on the loans, create liquidity in an otherwise illiquid loan book and thus attracting pools of capital that would not otherwise invest in complex loan assets; harnessing the expertise of professionals highly experienced in working out complex loans and assets; aligning the interest of the work-out professionals with those of the bank and retaining upside from the creation of value while preserving future liquidity. The unique and innovative features of the transaction include:

1. the appointment by a UK bank of a globally reputed institutional asset manager with extensive expertise in the real estate classes forming collateral for the underlying loans to both manage the real estate loan portfolio and to source meaningful equity investment for the fund vehicle through its access to institutional capital;

2. investment holdings in Isobel are structured in a form which is easily transferable and investable, providing RBS with flexibility regarding the sale of its holding;

3. reduction of RBS’s exposure to the highly leveraged loans (including longer dated loans) which form part of the portfolio while benefiting from future recoveries (maximised through Blackstone’s active asset management) on the portfolio;

4. a UK resident structure is used to hold the loans; and

5. the structure takes account, and mitigates the impact, of derivatives (including several long dated derivatives).

The transaction structure is capable of being tapped and replicated for other loan portfolios and provides a model for future transactions in the market for banks seeking liquidity for their legacy loan assets.

**Tax**

The tax treatment of acquiring and holding distressed debt needs to be neutral (at worst) and advantageous (at best) for sellers and buyers. In “neutral” structures, the key drivers are:

1. no transfer taxes on moving the debt securities into the new ownership structure;

2. no material tax leakage at either the asset holding or investment vehicle levels;

3. ensuring investors/buyers pay no more tax in the structure than if they were to hold the underlying securities directly; minimising cash flow taxes during the buyer’s period of ownership; and

5. achieving an exit from the new structure which attracts no more tax than a comparable direct holding and sale of the securities.

Structures with a greater degree of tax planning may also seek to:

6. ensure tax relief is available to the seller for the “distressed” bit of the single asset or portfolio sold;

7. defer or eliminate a charge to tax on the “pull to par” or “part discount” component of the distressed assets over time;

8. segregate assets with attractive tax attributes into separate pools; and

9. give buyers/investors a better tax treatment in relation to their participation than a comparable direct holding and disposal of the underlying assets.

**Conclusion**

With the quantum of money looking to be deployed by the funds sector and the increased capital requirements in the banking sector leading to the contraction of balance sheets in the banking sector, asset debt sales are set to continue for the foreseeable future. In a low interest rate environment many funds with appropriate expertise can achieve attractive returns for investors buying loan assets at a discount but still represents an attractive exit for the bank.

The buying and selling of debt involves a clear understanding of the overall market and market related issues, the normal process used for auctioning debt, the approach to due diligence and the legal documentation for effecting the sale and perfection of the interests transferred. Also of importance is a clear understanding of the tax and regulatory issues from both a buyers and sellers perspective.
Paul has been involved in the European debt markets since the mid-1980s. He has more than 25 years’ experience in structured finance, debt trading and work outs. He has advised extensively on both the buy side and sell side as well as note holder steering committees, lenders, swaps providers, collateral managers, special servicers and insolvency practitioners. Most recently Paul has advised on many of the high profile loan trades and restructurings including Uniinvest (Dutch commercial real estate), Centaurus and Infinity Soprano (German multifamily), Tahiti (hotels), The Mall (shopping centres) and Isobel (mixed commercial loans). He has worked extensively with funds and co investors establishing appropriate structures for acquiring and holding assets and advised on promote and inventive arrangements for asset managers and management teams. In addition to debt trading, Paul has worked with funds establishing new debt origination platforms as funds have entered the direct lending market across a range of assets classes. Paul has extensive experience across a range of assets classes including commercial and residential mortgages, infrastructure debt, consumer loans, auto loans and equipment leases. Geographically Paul has advised on transactions throughout our Europe and Asia.

Lucy is a banking and capital markets specialist who advises clients on a broad range of finance transactions, including securitisation, structured finance and asset-backed finance transactions in the UK and across Europe, with a particular focus on the real estate sector. Her experience includes advising on residential mortgage securitisations, warehouse facilities and covered bond programmes, commercial mortgage securitisations, capital markets debt funding programmes, synthetic securitisations and credit default swaps, collateralised loan obligations (including use of fund technology), complex derivatives transactions and repackaging transactions/programmes. Lucy is particularly experienced in advising buyers, sellers and financiers on debt portfolio sales and related finance transactions and has been involved in many recent bank divestment projects in the UK and across Europe.

The Securitisation and Structured Finance team at BLP comprises structured finance experts with a complimentary mix of excellent technical skills, industry experience and market know-how. Our team has a growing reputation for delivering first rate legal advice to major clients in the industry. We have a genuine understanding of the commercial drivers, concerns and ambitions of our clients and market participants.
So 2013 is finally here. The “CMBS refinancing cliff” talked about so much over the last four years or more, with a blend of gloom and optimism, has arrived. In an environment which has seen very little by way of new money securitisation issuance since 2007, it has been the hope of many under-employed bankers and lawyers in the City that the second half of 2013 will see an explosion of activity as vast numbers of CMBS deals issued at the very height of the market reach their expected or legal maturity and are required to be refinanced. For the investors in the subordinated tranches, however, the very real concern is that they, like their mezzanine lender counterparts in the leverage finance market, will be the losers when the deal is refinanced.

The obstacles are obvious. To say that this is a very different environment from the one in which these commercial loans were financed simply does not do justice to the paradigm shift which has occurred in the intervening seven years. When these maturing CMBS transactions were issued:

- There was a vast shadow banking market created by the SIV’s and arbitrage conduits which tapped short-term credit markets and created investor capacity which gobbled up new transactions almost as fast as they could be issued.
- The regulatory capital environment was a world away from that which the proposed Basel III amendments will implement.
- Many commercial property values were higher than they are now, with an underlying assumption by investors that such values would only ever increase, and consequently loan to value ratios with little or no margin for declining property valuations were commonly regarded as acceptable by investors.

These are very different times. And the numbers are staggering: between 2006 and 2007, US$ 142.67 billion of European CMBS was issued with a maturity falling in 2013 to 2014 (source: Commercial Mortgage Alert). That is a vast amount of debt requiring to be refinanced in the 2013 to 2014 window.

The refinancing of such a quantity of debt would require an enormous amount of available capital in the market. But the investor appetite and the capital available for this kind of asset has contracted hugely since 2007.

In July 2007, funding through asset-backed commercial paper conduits provided US$ 1.2 trillion of liquidity to the market (source: Board of Governors of the Federal Reserve System), some US$ 250 billion of which was in the European ABCP market (source: Fitch 2013 Outlook: Global Asset-Backed Commercial Paper). Today, the total ABCP market is around US$ 300 billion (source: Board of Governors of the Federal Reserve System), some US$ 35 billion of which is in the European ABCP market (source: Fitch 2013 Outlook: Global Asset-Backed Commercial Paper).

While there is no reason to think that the ABCP issuance market will shrink significantly further than it already has (although proposals such as the introduction of the liquidity coverage ratio may cause some further shrinkage), there is certainly unlikely to be any material increase in liquidity from that sector. In addition, continued uncertainty about Basel III and other, specifically EU-directed, capital adequacy requirements due to the proposed implementation of CRD IV makes it unlikely that new ABCP conduits will be established in the European markets until the regulatory and capital requirements are clearer. In short, the capacity of ABCP conduits to absorb the refinancing of CMBS has reduced by some 75 per cent since 2007 and it does not look like it is coming back any time soon.

Significant additional liquidity has been pumped into the market through the European Central Bank’s Long Term Refinancing Operation and the Bank of England’s Special Liquidity Scheme and Funding for Lending Scheme. However, the capacity of these schemes has already been heavily utilised by new loans originated over the last five years and there is a real question as to whether they will be able to provide material liquidity for the refinancing of heritage CMBS coming to maturity.

On the face of it, this looks bleak. More commercial real estate loans need to be refinanced over the next two years than the current market (or artificial market through central bank schemes) apparently has either liquidity or appetite for, this problem is compounded by the higher loan to value ratios required for such refinancing due to underlying property prices declining. Some radical rethinking is required.

In terms of whether a refinancing is even achievable in relation to a particular CMBS, lenders we have spoken to would argue that it depends on the underlying credit and that each credit is different. An issuance backed by a portfolio of retail properties outside a main urban centre is a very different refinancing prospect to a portfolio of office properties with anchor tenants in the oil and gas industry. This is a story we have all heard before when the leverage finance market faced the same refinancing issues in 2011. Cyclical businesses (such as retail and building component manufacturers) are a more challenging credit for refinancing purposes when compared with, say, a resource or a general manufacturing company.

So perhaps the trick is to take a look at the lessons learnt when the much feared wall of maturities in the leverage finance sector was hit in 2011 and how the leverage finance lenders and PE sponsors responded.
This was by far the most common approach taken in the leverage finance space where the view was that the underlying business, while fundamentally sound, was a victim of the general economic malaise arising from state austerity programmes. PE sponsors, unable to find buyers for the business (there is only so much money that CFOs of trade buyers are prepared to spend in these uncertain times) and facing flat or declining EBITDA numbers would opt for covenant resets and/or covenant holidays (replacing them with LTV ratios), waivers or standstills of existing defaults and extension of maturities in exchange for increased margins (albeit for the most part no or minimal cash paid margins) and lenders would agree to that in exchange for sizeable consent fees and the chance to not have to take the write down of the credit on their books. Obviously this “kick the can down the road” approach (so favoured by the banks and their new state owners), can only go on for so long before the debt burden of the underlying business becomes unsustainable. 2014 will prove to be a challenging time for the leverage space as these deals reach the end of their extension or holiday period.

In contrast the analysis for issuances in the CMBS space is necessarily more granular. CMBS issuances are made up of portfolios of properties with different geographical and commercial purposes and as such can be sold piecemeal (unlike leverage deals which were valued on an enterprise value basis and a sale of the components businesses and/or assets would have netted little joy for any of the stakeholders).

As a result, there has been a string of private disposals from portfolios backed by CMBS issuances in the run up to 2013. These disposals fall into two broad categories:

- the most attractive properties being sold in order to prepay the senior notes; and
- properties being refurbished (by the injection of new equity and/short term priority capex debt) in order to secure long-term anchor tenants (all done with the consent of the senior noteholders in exchange for a consent fee and an extension of the notes past their expected maturity) and then being sold to prepay the senior notes.

It is this latter category that has the most in common with the consent, amend, and extend story in the leverage finance market. Whether these refurbishment/disposal plan scenarios pan out with the continued economic uncertainty in Europe remains to be seen.

**Consent, Amend and Extend/Pretend**

While the idea of debt buybacks in the leverage space never took off (partly in due to the CFOs desire to maintain cash reserves) and the refusal of the leverage market participants to trade the debt at prices low enough (and therefore take the hit to their balance sheets) to be attractive to PE sponsors to inject additional equity/shareholder debt in order to fund the purchases, in the CMBS space, there are some lessons to be learnt from these deals and the optionality described above. In addition, unlike leverage loan participants (traditionally banks), capital market securities (including CMBS) are, by their very constitution, more tradable and are likely to be held by participants which may not have acquired them at par and as such be open to the arbitrage opportunity of a buyback. In short, buybacks are not a new concept in the capital markets space.

In the capital markets space generally, buybacks can take the following forms:

- **Privately Negotiated/Open Market Purchases** – Such purchases are best suited to situations where ownership of the target securities is concentrated among relatively few holders or the issuer intends to repurchase a relatively small percentage of the outstanding securities. These purchases can typically be completed relatively quickly with less documentation and greater flexibility around the repurchase price compared to tender or exchange offers. Among other considerations, care must be taken to ensure that (i) these repurchases do not constitute a tender offer under the relevant listing rules where the CMBS was issued (the “Listing Rules”), (ii) no purchases are made while the issuer is in possession of material non-public information, and (iii) any disclosure of information to holders of the target securities is made in accordance with the Listing Rules.

- **Cash Tender Offers** – In a tender offer, the issuer will make an offer to repurchase some or all of the target securities, often at a premium to the secondary trading price, but at less than the face value of the securities. The purchase price offered for the securities is typically either a fixed amount (a “fixed-price” tender offer) or, in certain circumstances, the present value of the debt securities as of a designated date; determined by discounting the face value or the earliest applicable redemption price of the notes at a discount rate based on a fixed-spread over a benchmark Treasury rate (a “fixed-spread” tender offer). Dutch auction pricing mechanisms can also be used in certain tender offers. Tender offers for notes subject to substantive covenants (typically non-investment grade, nonconvertible securities) may be coupled with consent solicitations for both strategic and practical reasons discussed below. Listing Rules requirements will apply.

- **Exchange Offers** – An exchange offer is usually best undertaken where the issuer has insufficient cash available to repurchase the target securities or believes there is an appetite among target holders for an exchange security with terms beneficial to the issuer. The same Listing Rules requirements applicable to cash tender offers will likely be also applicable to exchange offers. In addition, an exchange offer involves an issuance of new securities. It must therefore comply with the relevant listing requirements.

- **Consent Solicitations** – A solicitation of consents from holders of target securities to amend the terms of the relevant transaction documents can also be used as a debt restructuring tool, either conducted alone or in tandem with a tender offer or exchange offer. Consent solicitations can be used to modify or eliminate covenants and events of default to permit a specific contemplated transaction or to more broadly eliminate covenants providing the issuer generally greater ongoing operating flexibility. When conducted together with a tender or exchange offer they are often referred to as “exit consents”.

**Buybacks**

In September 2008, the Loan Market Association launched the debt buyback transaction riders in order to deal with concerns over the impact of obligor groups/sponsors’ affiliates buying back debt on the market at less than par. The riders, often imposed by the lenders into pre-2008 vintage deals as part of the consent, amend and extend process were designed to deal with the legal issues surrounding whether such purchases would constitute legal repayment of debt (and more importantly the commercial concern that such purchases would be considered prepayment of the selling lenders cutting across the intended pari treatment of the lenders in that facility, in effect extracting cash/value from the obligor group in preference of the seller lender). The riders dealt with the treatment of such repurchased debt on the financial covenants in the facility and the voting rights of the purchasing party on that debt against the rest of the syndicate.

The riders gave lenders three options: (1) an absolute prohibition on buybacks; (2) permitted buybacks in limited circumstances, for example only from excess cash flow (“Permitted Buybacks”) with voting rights; or (3) Permitted Buybacks but with disenfranchised voting rights.
Unfortunately, as increasing scrutiny has been applied to the documentation, certain common issues/deficiencies have become apparent. Most common of these are the controlling creditor provisions at the security level and the noteholder resolution provisions in the terms and conditions (and indeed in the interaction between them). It is not uncommon to find that while the security package itself on the face of it permits the majority lenders the right to enforce the security in the event of a default (such as non-payment) and take possession of the underlying asset, anything other than a straight sale of the collateral and application of the proceeds of disposal would amount to a “basic terms modification” and therefore require an extraordinary resolution (commonly 75 per cent of the noteholders) by each and every class of notes. Innovative solutions, such as a distribution in specie of the underlying loans to the noteholders, are often therefore impossible unless 75 per cent of the noteholders across all classes agree to it.

As a result, any proposed restructuring which involves the write-off of any principal under any class of notes, or a distribution in specie of the underlying asset in lieu of repayment of the notes, or any combination of these, will have to be looked at on a case by case basis by reference to the terms of the security package and the terms and conditions of the notes.

### Enforcement and Prepacks

Much has been made in the leverage market of the valuation issues arising from the series of cases starting with *Re Bluebrook Ltd and others [2009] EWHC 2114 (Ch) (IMO Carwash)*. In these cases, the mezzanine/subordinated creditors’ challenge to valuations in the context of prepack enforcements and schemes of arrangement has led to reams of legal and commercial articles in journals and blogs about the merits of desktop/present market valuations as opposed to “Monte Carlo” or discounted cash flow valuation.

Are there any lessons to be learnt from these in the CMBS space? Well, leverage finance documents and their inter-creditor arrangements, prior to 2008, did not include an obligation for senior creditors to consult with, or use, the valuation raised by mezzanine creditors. Something the mezzanine lenders are remedying in the new money deals in which they want to become involved. In contrast, CMBS deal documentation, which are in theory cash flow deals but often parsed as LTV/Asset based values deals, have always included express provisions for valuation on enforcement which all stakeholders are bound by. Will the courts recognise a challenge to such valuation provisions?

It would seem highly unlikely and if that is correct then it is a double-edged sword. A pre-agreed valuation methodology is all well and good but if it does not give the subordinated creditors the answer they want it may have been better for them if such provisions were not there.

Some comfort can be taken by the subordinated creditors (who unlike their mezzanine lender counterparts in the leverage universe seem to be more prepared to entertain the idea of providing additional capital into the structure), there have been a number of scenarios where the market valuation shows that while the value breaks in the senior debt, the subordinated creditors have done a debt for equity swap deal with sponsors for a credit bid of the property portfolio and taken advantage of certain rating agency imposed features (such as the swap, as we discuss below) in order to deal with the senior noteholders in a pincer movement with the equity.

### Gaming the Hedge

In a substantial number, but not by any means all, of the CMBS issuances with a *circa 2007* vintage, there is an unusual feature borne out of the markets of the day. In the halcyon pre-crunch days, there was some concern about inflation and what central banks would do to curb it and Greenspan, King and Trichet were all strong advocates of using interest rates to regulate any overheating in the economy. Back then and in that context, interest rate hedging for limited recourse CMBS structures was seen as being not only prudent but commercially savvy as a hedge could break either in the money (in which case, the structure had a windfall) or protect against the rumbling of interest rate rises coming from the central banks. Well, those days are long gone and that established wisdom has fallen by the roadside along with Greenspan’s premature victory declaration over boom and bust cycles and Brown’s fiscal prudence.

Nonetheless, one of the features from those bygone days, which will come home to roost this year, is the fact that while a significant number of CMBS issuances will come due this year, the underlying loans comprising such issuances are paired with interest rate hedges which have a scheduled termination date of 20 to 25 years from inception. In short they do not terminate when the underlying loans come due, and are therefore in some ways not a true hedge. These hedges were put in place with a mismatched maturity in an effort to reduce the cost of buying/pricing such hedges (with a view that such hedges could be divorced from the underlying loans and be traded out through central clearing house such as ICE when the loans were refinanced at maturity).

As with the loss of liquidity in the market, there has also been a loss of appetite for such capped/fixd-rate hedges in the current market (ironically because of the same environment) so it is not generally possible to sell them on the open market. Further, these hedges, as with all derivative instruments, have at any point in time a mark to market value on the books of the hedge provider and if closed out prior to their scheduled maturity will have a close out amount payable under them. In the current long-term repressed interest rate environment, that is a substantial close out amount.

What makes this interesting is that amounts payable under these hedges, rather like “pure” liquidity facilities, often rank in priority to the senior noteholders in the waterfalls. In the context of any restructuring or refinancing with a deeply in-the-money hedge provider (other than a refinancing at par), it is therefore not the senior noteholders which are first priority creditors but rather the hedge counterparty (which the rating agencies require to be a rated provider and therefore by definition a bank). Suddenly, the subordinated creditors find themselves having to deal with a new stakeholder (who as indicated above could be a substantial creditor) and the discombobulated senior noteholders find the shoe on the other foot as they find themselves negotiating with a stakeholder who has higher priority than them and little or no commercial incentive to come to a compromise deal (remember, hedging desks regularly book their trades on a mark to market basis from inception and are loath to change that valuation as it impacts on their P&L).

So what is the solution? Well, the market has evolved several approaches. Some sponsors have found new money providers to buy out and take over the priority position of the hedge providers in order to leverage a position with the senior noteholders who thought they were sitting pretty at the top of the waterfall. Others have monetised the swap and amended the terms of the hedges so that they become loans equal to the close out amount. Some of the more innovative institutions have moved the hedge from the hedging desk’s balance sheet to the proprietary portfolio balance sheet and
recast it as a variable principal loan equal to the close out amount from time to time. In many ways, the solution depends on the swap and how it is booked.

**Conclusions**

The need to refinance a vast amount of CMBS in an illiquid market is a problem which cannot be kicked down the road forever, so we are likely to start seeing an increasing number of true restructurings as opposed to “consent, amend and extend” arrangements largely carried out to date. It is unlikely that these are going to be refinanced at par, and therefore either the sponsor will have to inject further equity into the new financing, or one or more classes of the existing noteholders are going to have to accept either a write down or a distribution in specie of the underlying asset. Compared to the leveraged finance market, there is probably a more ready and liquid investor market for the underlying loans, and collateral packages can be more readily cherry picked to realise value. The swap, which is likely to be significantly out of the money from the perspective of the borrower given the movement in interest rates between the deal’s origination and now could add an interesting dynamic to the inter-creditor negotiations, and in addition could be monetised or used to incentivise the swap provider to participate in the deal’s refinancing.

For over four years now the market has been speculating about how the CMBS refinancing cliff will pan out. One thing is for sure: by this time next year we should know the answer.
Chapter 6

Argentina

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

In general it is not necessary for the sale of goods and services to be enforceable, that they be instrumented under a specific form required by law. In Argentine law, the principle of freedom of forms governs. However, contracts above a certain value have to be instrumented in writing. Additionally, certain goods exist whose sale must be evidenced by certain formalities. Invoices can constitute evidence of a contract. It is also possible to infer the existence of a contract based upon a historic relationship between determined parties. For such purposes, invoices constitute one of the relevant elements for determining the presence of a contractual relationship.

1.2 Consumer Protections. Do Argentina’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Except for certain operations (e.g., credits deriving from the use of credit cards), Argentine laws do not fix limits to the interest rates agreed upon by the parties to a contract. Certain court rulings have admitted that grossly out of market interest rates were usurious, and reduced them _ex-officio_. Argentine legislation envisages the right of all creditors to claim indemnification due to late payment; in particular, in the case of obligations to deliver sums of money, the indemnification owed by the defaulting debtor is the payment of interest.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

In principle, the contracts utilised for such purposes will be those existing under private law but formalities required by specific rules of administrative law may exist. Likewise, the enforcement of contracts may be conditioned to compliance with certain prior requirements.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Argentina that will determine the governing law of the contract?

The governing law will be determined in the first place by the applicable international treaty. If no international treaty is applicable, the Argentine Civil Code will apply. In general terms, the main regulations are: (i) sections 1,209 and 1,210, which set forth that the contract will be governed by the laws of the place of performance of the (characteristic) obligation; and (ii) section 1,205 that sets forth that the applicable laws will be those of the place of execution of the contract. The rule varies if the receivable is in connection with the sale of (i) movable assets (personal property) with a permanent situation in Argentina and with no intent of transport abroad, and (ii) real estate, which in both cases shall be governed by Argentine law.

2.2 Base Case. If the seller and the obligor are both resident in Argentina, and the transactions giving rise to the receivables and the payment of the receivables take place in Argentina, and the seller and the obligor choose the law of Argentina to govern the receivables contract, is there any reason why a court in Argentina would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Argentina but the obligor is not, or if the obligor is resident in Argentina but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Argentina give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Under Argentine conflict of law rules, the seller and the obligor are free to choose the law which will govern the receivable, provided there is a reasonable connection between the parties or the...
receivable contract and the law chosen. For instance, such connection may arise from the place in which obligations will be performed, the place in which the receivable contract is executed, the domicile of one or more of the parties, etc. There are limitations to the recognition of foreign law based on Argentine international public policy. This concept is applied to the case in a *posteriori* basis (i.e. it is not a fixed set of rules which the chosen law must abide by, but certain core principles which the chosen law must not violate, and said violation or lack thereof is determined by a judge after analysing the case, the principles, and the solution granted by the chosen law). It is important to point out there are not many case law precedents where a judge has ruled that certain laws are in violation of Argentina’s international public policy, and there are even fewer cases where said violation was determined due to the choice of law in a commercial contract. This notwithstanding, there is a tendency to acknowledge certain principles which operate *a priori* and are thus inflexible rules which are applicable no matter what law the parties have chosen. Said rules are also known as “immediate application norms” due to the aforementioned fact that they are applicable even if the parties have chosen a different law to govern the contract. However, these fixed rules only apply to certain specific cases (for example, corporations incorporated abroad which carry out their main business activities in the country).


### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does Argentina’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Argentina’s laws or foreign laws)?

There is no specific rule, and therefore there is freedom to agree.

#### 3.2 Example 1: If (a) the seller and the obligor are located in Argentina, (b) the receivable is governed by the law of Argentina, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Argentina to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Argentina, will a court in Argentina recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Argentina’s own sale requirements?

The domicile of the seller is one of the usual connections used by the Argentine conflict of law rules, therefore, if the seller resides in Argentina, an Argentine court would probably consider that as a reasonable connection giving effect to the choice of the law of the seller’s country for these kinds of commercial relations and that sale would be effective against the seller (subject to some formalities detailed in question 4.2). Bankruptcy law provisions regarding rights of creditors should be taken into account, as well as provisions relating to reciprocity in case of bankruptcy (Argentine bankruptcy law sets forth that foreign creditors shall only be allowed to present themselves in the bankruptcy proceedings in Argentina and file a claim for their outstanding credit (the credit of which is payable abroad) before the Argentine judge if, likewise, the laws of the country of said foreign creditor would allow an Argentine creditor to file a claim for his or her outstanding credit (payable in Argentina) in any bankruptcy proceedings in said foreign country).

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Argentina, will a court in Argentina recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

See the answer to question 3.2.

#### 3.4 Example 3: If (a) the seller is located in Argentina but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Argentina recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Argentina’s own sale requirements?

Under Argentine conflict of law rules, the seller, the obligor and the purchaser are free to choose the law which will govern their commercial relation provided there is a reasonable connection between the case and the law chosen. If the election is valid and the sale has been legally perfected under foreign laws, an Argentine court would recognise that sale as being effective provided that principles of Argentine international public policy are not violated. In case of bankruptcy, law provisions regarding rights of creditors should be taken into account, as well as provisions related to reciprocity in case of bankruptcy.

#### 3.5 Example 4: If (a) the obligor is located in Argentina but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Argentina recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Argentina’s own sale requirements?

If the applicable law was validly chosen, as mentioned in the previous answer (i.e. that there was a reasonable connection between the obligor and the seller, and between the seller and the purchaser to choose in their relations the laws of the seller), and provided that Argentina’s international public policy was not violated, an Argentine court will recognise that sale as being effective against the obligor. Bankruptcy law provisions regarding
The customary method will be an assignment contract, listing the sold receivables and the names and domiciles of the debtors thereunder. When the receivable is under litigation, a sale of real estate, a credit secured with real estate or originally documented in a public deed, the purchase agreement will need to be documented in a public deed in order to be effective. For securitisation purposes, receivables are usually assigned to a trust (under Argentine law - trust), and the property of such receivables segregated from other property of the trustee. See the response to question 7.2. The customary terminology is “assignment”.

The sale of receivables is legally effective between the purchaser and seller upon the execution of the assignment agreement and with the delivery of the receivable contracts to the purchaser or a custodian (for instance, the seller). However, for the transfer to be effective vis-à-vis third parties other than the debtor, the law requires that the notice complies with certain formal conditions that provide authenticity to the fulfillment of the notice requirement, that is to say, through a public act. By “public act”, jurisprudence and scholars’ opinions have deemed that the participation of a public officer (i.e. public notary, courts) implies the existence of a public act. Depending on the quantity and size of the loans to be transferred, hiring notaries to serve notices to each debtor has a tremendous impact on the cost and timing of any transaction. Instead, to meet the “public act” requirement, the securitisation industry in Argentina has been publishing notices in the federal official gazette. There is no court precedent that has confirmed yet that publishing general notices complies – or not with such legal standard.

A very important exception to the notice requirement has been established through Law 24,441 of Trusts [trusts under Argentine law are different to the Anglo Saxon trusts], which establishes that the sale of the receivable without notice of the assignment may still be enforceable vis-à-vis third parties when (i) the receivable contract expressly exempts the seller from the notice requirement (customary in receivable contract forms in Argentina), (ii) the transfer is made to securitise a credit portfolio and collateralise the issues of securities, and (iii) that the securities to be issued are registered with the Argentine Securities Commission (“CNV”). Among other transfer of assets that have to be recorded, and regardless whether the notice requirement is exempt or not, any transfer of a mortgage securing a loan has to be recorded with the real estate registry of the province where the relevant real estate is located. This recording impacts on the cost and timing of any transaction structure.

To avoid such a costly burden applicable to mortgage loans, Law No. 24,441 has also admitted the issue of mortgage securities upon the existence of a mortgage loan in the first degree of preference, which expressly authorises such issuance in the act of agreeing on the loan and creating the mortgage on the property. The issuance of the mortgage security shall be registered by the registry of real estate. The mortgage security represents the right of the seller under the mortgage loan. Once its creation has been recorded, it can be transmitted without the need to give any notice to the debtor or recording the transfer with the real estate registry. Nowadays, standard forms of mortgage loans suggested by the Central Bank and used by banks include the creation of mortgage securities in order to facilitate sales and securitisations.

Mortgage securities are usually book-entry securities. In this case, the designation of the entity in charge of the records of this kind of mortgage securities (where the public deed of the mortgage shall be deposited) shall be expressly registered within the corresponding registry of real property. The register of the mortgage securities shall be under the charge of clearing houses, banks or corporations organised exclusively for such purposes. Transfer of these kinds of mortgage securities shall be registered with such entity upon the filing of the corresponding transfer instrument, and it shall produce legal effects with respect to the debtor and third parties without any need to give notice of such transfer or registration to the registry of real property.

The general regime described in question 4.2 above is applicable also to the sale of consumer loans and of mortgage loans. With regard to the sale of Promissory Notes, the sale and perfection of
such are effected by endorsement of the note. Lastly, with respect to the marketable debt securities, it is only necessary to notify the agent that holds the register of ownership of sold securities.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice—such as cutting off obligor set-off rights and other obligor defences?

Please refer to the first two paragraphs of the answer given to question 4.2. As long as the receivables contract does not expressly prohibit assignment, it is not necessary for the seller or for the purchaser to obtain debtors’ consent to the sale of receivables. Contrarily, if the contract prohibits (or in any other manner restricts) the assignment, debtors’ consent should be obtained. Notice perfects the assignment vis-à-vis third parties. Other benefits of notice are: (a) the seller ceases to be the owner of the receivable, and he can no longer assign that credit, receive payments from the debtor or take any action in connection with the collection of that credit; (b) the debtor shall be notified of his creditor’s identity; and (c) third parties shall know the assignor’s condition with regard to the assigned credit.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective—for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

The notice or acceptance to be delivered to the debtor does not need to fulfill any specific requirements; any means is considered appropriate to notify. Please refer to the first two paragraphs of the answer given to question 4.2. According to section 1,464 of the Argentine Civil Code, in case of insolvency of the seller, the notice of the assignment—or its acceptance—could be delivered after the default of payments, but it will be ineffective against the creditors of the insolvency estate if it is delivered after the proceedings of the insolvency declaration.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Argentina? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Argentina recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Undoubtedly. The seller would have to indemnify the debtor against any loss arising in connection with the sale of the receivables, in case that, even though that act was expressly forbidden in the contract, the seller sold them nevertheless.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Other than identifying the original amount and the debtor, there are no statutory additional rules regarding the identification of sold receivables. The more information, the higher the likelihood of avoiding potential litigation.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redeemption without jeopardising perfection?

None of the economic characteristics above will prevent perfection of the sale. A provision by which an option is granted to the seller to repurchase the receivables may, according to some court precedents and scholars’ opinions, prevent not only perfection, but may also affect the validity of the sale.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, he can. However, the agreement to make continuous sales will not be enforceable in the event of insolvency of the seller.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Argentine law permits the sale of future receivables. Thus, the seller can voluntarily transmit inter vivos future receivables without any specific form different from that required in question 4.2. Argentine law governs the general principle of freedom of forms, as stated in section 1,278 of the Argentine Civil Code. In connection with enforcement in the insolvency scenario of the seller, please see question 6.5 below. Finally, Argentine law does not permit the sale of future mortgages or pledges or those that were not created at the time of the sale. This restriction will not apply to the assignment of the agreement from which future credits will arise.
4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Unless prohibited under the security contract itself, pursuant to Article 1,458 of the Civil Code, the sale/assignment of a receivable (credit) automatically includes all related securities thus entitling the new creditor to enforce such securities. It is customary, however, to serve notice of the transfer to the third parties that granted such securities (e.g., the owner of the mortgaged land, a pledgor of personal property, etc.).

5 Security Issues

5.1 Back-up Security. Is it customary in Argentina to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Please note that in all transfers of rights for valuable consideration there exists a legal and implied guarantee of the validity of the title (garantía de evicción), that is to say, Argentine law foresees that if a purchaser, due to a cause prior to, or contemporaneous with, the acquisition, by virtue of a judgment is deprived totally or partially of the rights acquired or suffers any other loss with respect to its ownership, enjoyment or possession rights, the purchaser has the right to be indemnified by the seller. Otherwise, it is not customary in Argentina to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Argentina, and for such security interest to be perfected?

Please refer to the answer to question 5.1 above.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Argentina to grant and perfect a security interest in purchased receivables governed by the laws of Argentina and the related security?

The requirements to be fulfilled depend on the type of security to be created. The most common security interests that are granted are the pledge, the collateral trust and the assignment. The requirements to be fulfilled in the case of the pledge and in the assignment are mostly similar. For example, the most important requirements are that: (a) the debtor of the pledged/assigned credit be notified (though, there are certain exemptions in cases regarding assignments to trusts that publicly offer securities); (b) the credit be evidenced by a written document; (c) the document in which the credit is evidenced be delivered to the creditor or to a third party; and in the case of the pledge agreement (d) it should be perfected through a public deed or a private document with true date and it will have to indicate the amount of the secured obligation.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Argentina, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Argentina or must additional steps be taken in Argentina?

In principle it should be treated as valid and perfected in our country. Nevertheless, in the case of a security interest over receivables payable in Argentine, an Argentine court could consider such receivables movable assets with a permanent situation in Argentina (please refer to the answer to question 2.1 above), and therefore construe the validity and efficacy of the said security interest in the light of Argentine law.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

The requirements to be complied with depend on the type of security interest created and the assets to which such security interest applies. It is worth pointing out, however, in the case of a pledge (a security interest frequently created under our law), that if the same was to apply to certain negotiable securities originated in accordance with Argentine law and transmissible by means of endorsement, the notification of the granting of the security interest to the assigned debtor could be dispensed with. In general, when granting a loan or financing any payment, the lender will require the debtor to pay a life insurance linked to the loan covering the loan or credit balance. In case of a mortgage or pledge, an additional insurance covering the asset shall be taken out. Regarding insurance requirements, if the security interest was a mortgage loan or a pledge granted by certain financial entities regulated by law (such as banks), the mentioned life insurance linked to the loan is mandatory.

5.6 Trusts. Does Argentina recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, it does (fideicomisos).

5.7 Bank Accounts. Does Argentina recognise escrow accounts? Can security be taken over a bank account located in Argentina? If so, what is the typical method? Would courts in Argentina recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Argentina?

The most common legal figures to be used are the collateral trust or the commercial pledge over the bank accounts and the amounts deposited therein. In this sense, section 3,207 of the Argentine Civil Code provides for a pledge “in the hands of a third party” as different from a pledge in the hands of the creditor. However, the trust would be safer than the pledge (since a third neutral party – the trustee – should be the holder of the account). In case of a pledge, it works as any other pledge over contractual rights (e.g. the rights over the opening account contract) and the pledgor remains the owner of the account. With respect to the foreign-law garn of security taken over a bank account located in Argentina, in principle, it should be treated as valid and perfected in our country.
5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

If the security was validly granted, the secured party will have control on all cash flowing into the account. However, please see the comments made in case of insolvency proceedings (response to question 6.5, among others).

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

It will depend on the wording and limitations imposed by the security agreement itself.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Argentina’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

The Argentine Bankruptcy Act contemplates three types of insolvency proceedings: bankruptcy reorganisation (concurso preventivo); out-of-court composition with creditors (but with limited court intervention after an agreement is reached) (acuerdo preventivo extrajudicial); and bankruptcy liquidation (quiebra). If the sale has been perfected in conformity with the law and if there has been a true sale, neither the opening of a bankruptcy reorganisation of the seller, nor the application for out-of-court composition with creditors, nor the declaration of bankruptcy liquidation of the seller could prevent, or give reasons for, an official insolvency to prevent the exercise of the rights of the purchaser over the acquired receivables.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

If the sale has been performed in accordance with the law and if there has been a true sale, the insolvency official could not prohibit the purchaser’s exercise of rights.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Argentina for (a) transactions between unrelated parties and (b) transactions between related parties?

Under bankruptcy liquidation proceedings, acts exist that could be directly ineffective by virtue of the law or, in other cases, by virtue of a court resolution. The Argentine Bankruptcy Act contemplates a “suspect period” which takes place between the date on which the suspension of payments (cesación de pagos) began and the date of the bankruptcy adjudgment, even though, for purposes of this matter, the date of suspension of payments (cesación de pagos) cannot be backdated further than two years from the date of the bankruptcy liquidation adjudgment or of the bankruptcy reorganisation filing (provided that it has preceded the relevant bankruptcy liquidation). The Argentine Bankruptcy Act envisages that the following acts performed by the debtor within the “suspect period” are directly ineffective by virtue of the law in respect of the creditors: (a) gratuitous acts; (b) anticipated payment of debts whose expiration should have occurred on the date of the bankruptcy liquidation adjudgment or later; and (c) the granting of a mortgage, pledge or any other preference, with respect to a non-expired obligation that originally did not have such security interest. On the other hand, other acts prejudicial to creditors, celebrated during the “suspect period”, can be ruled ineffective by the bankruptcy court, if the third party that celebrated the act with the insolvent party had knowledge of the suspension of payments (cesación de pagos) of the debtor. It should also be mentioned that it is the third party that celebrated the act with the insolvent party that must prove that such act did not prejudice the creditors. All that has been explained is with regard to bankruptcy liquidation but is not applicable to bankruptcy reorganisation or out-of-court composition with creditors. Lastly, we should mention that in the Argentine Civil Code the possibility of filing an action for fraud exists as envisaged with respect to all acts that may have caused, or aggravated, the insolvency of the debtor.
6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Argentina, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

In general, we can say that if the price for the receivable was already paid, the purchaser will collect his claim in the same conditions as any other unsecured creditor. And if the price was not yet paid, performance of the contract will be conditioned to the decision of the bankruptcy judge. An important issue in this respect is the financing of the production of the good for which the future receivable will be created.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Argentina establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no law that specifically provides for securitisation transactions. The one that is probably more specific is Law No. 24,441. Also, in case the securitisation transactions involve public offering of securities the applicable law will be Law No. 26,831.

7.2 Securitisation Entities. Does Argentina have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes, it does. It is Law No. 24,441, which governs the creation of “financial” trusts, in other words, trusts that issue securities. Under Argentine law, the trust is not an entity, but is an estate separate from those of the trustee (purchaser) and the settler (seller). Accordingly, assets of the trust shall not be the target of any action by the trustee’s and seller’s creditors and their respective bankruptcies (except fraud). The trustee is in charge of operation and management of the business of the trust. Only banks licensed in Argentina and entities authorised by the National Securities Commission may act as trustees. The trustee shall not be personally liable to any obligation of the trust, which shall only be payable with the assets of the trust, except when the trustee acted negligently or with willful misconduct. The entities authorised by the National Securities Commission are required to meet a relativity low solvency requirement.

7.3 Non-Recourse Clause. Will a court in Argentina give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Yes, it is highly probable that a court will hold such a contractual provision among the parties as valid.

7.4 Non-Petition Clause. Will a court in Argentina give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

As long as the purchaser is a trust, a trustee would not be personally liable to any obligation of the trust, which shall only be payable with the assets of the trust, except when the trustee acted negligently or with willful misconduct.

7.5 Priority of Payments “Waterfall”. Will a court in Argentina give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

In regular situations, the answer will be yes. In the case of insolvency proceedings and generally speaking, the court would give effect to the subordination of a credit to others.

7.6 Independent Director. Will a court in Argentina give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In principle, such a provision should be treated as valid and perfected in our country. However, in case the provision forbids the directors to take certain actions in specific sensitive subjects, it could be declared by the acting court to be against Argentina’s public policy (see the response to question 3.4 above, among others).

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Argentina, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Argentina? Does the answer to the preceding question change if the purchaser does business with other sellers in Argentina?

Foreign companies are authorised by the Argentine Companies Law to perform “isolated” acts of commerce in Argentina. Acts of commerce on a “habitual” basis require the registration of the purchaser. The answer would depend on the circumstances of the case and it would depend on the size and characteristics of the receivable portfolio acquired. However, in practice, due to tax and foreign exchange reasons, receivable portfolios are usually acquired by a locally-organised trust and, depending on whether or not funds are offshore or inshore, foreign investors would not need to be registered to do business in Argentina to purchase the securities issued by the trust with, as a consequence, less foreign exchange restrictions.
8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

If the seller is an Argentine company, no special licence would be required. However, it could be required to present a power of attorney to appear before a court. If it is a foreign company, it is probably convenient and, depending on the circumstances, in some cases mandatory that the foreign company becomes registered under either section 118 or 123 of the Business Associations Law (No. 19550, as amended).

8.3 Data Protection. Does Argentina have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Several rules protect the data provided by obligors, the most relevant being Law No. 25,326. It not only applies to consumer obligors, but also to enterprises. Please note that Argentina has a vast and strict data protection regime. For instance, Argentine data protection regulations require to collect data owners’ (who can be individuals or legal entities) prior, written, express and informed consent for any kind of processing of their personal data (except for a few exceptions). We remain at your disposal to analyse any specific measures or precautions to be taken regarding a particular project/situation. Please note that Argentina has a vast and strict data protection regime. For instance, Argentine data protection regulations require to collect data owners’ (who can be individuals or legal entities) prior, written, express and informed consent for any kind of processing of their personal data (except for a few exceptions).

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Argentina? Briefly, what is required?

Debtors of the sold receivables are considered consumers. Thus, the purchaser should have to comply with several consumer protection rules, the most relevant one being Law No. 24,240. Among other relevant requirements, that law requires: (i) giving true, objective, detailed and sufficient information of the given services, and respect all terms and conditions as they have been published and agreed; and (ii) avoiding clauses that restrict the rights of the consumer or enclose the faculties of the other party. In case of doubt in the interpretation of a clause, that which is most favourable to the consumer will always prevail.

8.5 Currency Restrictions. Does Argentina have laws restricting the exchange of Argentina’s currency for other currencies or the making of payments in Argentina’s currency to persons outside the country?

Yes, there are several, especially when foreign investors invest in securities issued by a trust organised in Argentina. There are restrictions to inflows, outflows and to the purchase and sale of foreign currency notes in Argentina. Restrictions vary depending on whether the person operating in the foreign exchange market is a resident or a non-resident of Argentina.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Argentina? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

The obligation to perform withholdings and applicable rates may vary depending on the nature of the receivables and the location of the beneficiary of the payment. For instance, in case the recipient of the payment is a local resident and interest is being paid, debtors who are companies or individuals that borrowed money for their business, have to make income tax withholdings on interest payments to the lenders. The withholding rate may vary from 3 per cent to 35 per cent. In principle, receivables originated in consumer loans are not subject to withholding. The purchaser of receivables may have to perform these withholdings, substituting the debtor, upon payment to the seller. In the case of the payment of interest to non-residents, withholding rates may vary from 15.05 per cent to 35 per cent depending on the beneficiary and its country of residence. In case a Double Taxation Treaty is applicable, this rate may be lower. In addition, the sale of receivables may also be subject to income tax withholdings.

9.2 Seller Tax Accounting. Does Argentina require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No specific accounting policy must be adopted.

9.3 Stamp Duty, etc. Does Argentina impose stamp duty or other documentary taxes on sales of receivables?

The receivable purchase contract may be subject to stamp tax in Argentina’s provinces and in the City of Buenos Aires (Argentina is a federal country). However, most jurisdictions exempt sellers and purchasers from stamp tax as long as the transfer was made for the purpose of a securitisation deal and the securities are registered with the CNV.

9.4 Value Added Taxes. Does Argentina impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

As a general rule, the sale of goods or services is levied by VAT with a 21 per cent rate. The sale of certain goods or services may be levied with lower or higher rates depending on the specific goods or services. The fees for collection agent services are also taxed with VAT at a 21 per cent rate. In the case of sales of receivables, VAT is imposed at the rate of 21 per cent on the spread between the value of the portfolio and actual purchase price. However, sales to a trust organised under Argentine law (the vehicle used for securitisation deals and the purchase of distressed credit portfolios in Argentina) are exempt from VAT.
9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Unless the receivables are part of the assets sold in the transaction qualifying as a Transfer of a Going Concern (Law No. 11,867), the principle is that the tax authority would only claim against the party that is liable. If the transaction qualifies as a part of a Transfer of a Going Concern, special procedures must be accomplished to exempt the purchaser from the tax liabilities of the seller. In the case of stamp tax, both parties are jointly and severally liable to pay the tax.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Argentina, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Argentina?

No, not as long as the purchaser does not reside or have a domicile in Argentina and does not maintain a permanent establishment in Argentina. If you consider a sole transaction of the purchase of receivables, the appointment of a servicer and the enforcement, we do not think that a purchaser would become personally liable for taxes in Argentina. However, depending on the circumstances, the debtor or the collection agent would have to make high withholdings on interest payments due to the fact that the creditor is domiciled abroad. For this reason, it would probably be more efficient to organise a local vehicle or a trust for the purchase.
Estudio Beccar Varela is a partner of the Firm. His professional activity is mainly concentrated in banking, and corporate finance with a focus in the oil and gas and mining sectors. He has also been acting as consultant to the World Bank in insolvency matters. Mr. Fortunati acted as leading local counsel for several major project financings, mainly related to mining, oil and gas, and utilities. He has been very active in the fields of out-of-court debt restructurings (work-outs), privatisation of state-owned companies, M&A and in the start-up of venture capital investments. He is member of the board of directors of several corporations, including his acting as independent director and a member of auditing committees, and an arbitrator to the MAE (the local OTC electronic market). He is a member of the Advisory Board of the School of Law of Torcuato Di Tella University, Buenos Aires, and teaches project financing in a postgraduate course on Oil and Gas Law, at the School of Law of the University of Buenos Aires. Mr. Fortunati founded the Firm Fortunati & Asociados in early 2003, a firm which has recently merged with Estudio Beccar Varela. He acted as General Counsel of Citibank in Argentina, after being partner of Estudio Beccar Varela, in Buenos Aires. Mr. Fortunati started his professional career as in-house counsel of Amoco Argentina Oil Company. He graduated from the Law School of the University of Buenos Aires in 1979.
### 1 Receivables Contracts

#### 1.1 Formalities

In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) There is no general requirement that an agreement for a sale or a provision of services be evidenced by a formal written contract between the parties. However, certain contracts do require the formality of writing, such as contracts for the sale of land (or interests in land) and credit contracts regulated under the National Consumer Credit Protection Act 2009 (Cth) (“NCCPA”) (which also mandates detailed form and content requirements). In some cases, electronic transactions legislation may allow a contract “in writing” to be entered into other than using a physical paper agreement. The Personal Property Securities Act 2009 (Cth) (“PPSA”) requires the agreement to be evidenced in writing and either signed by the seller or adopted by the seller by conduct.

(b) Where no special rules such as those noted in (a) apply, an invoice may be sufficient evidence of contractual relations provided that the basic requirements of contract formation are met (namely: offer; acceptance; consideration; certainty; capacity; and intention to create legal relations).

(c) Where no special rules such as those noted in (a) apply and the basic requirements of contract formation highlighted in (b) are met (including an intention to create legal relations), the conduct of the parties may be sufficient for a contract to be deemed to exist.

#### 1.2 Consumer Protections

Do Australia’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

The NCCPA regulates loans and leases (and, e.g., associated guarantees and mortgages) entered into with consumers, and regulates matters such as the contract form, disclosures and conduct. Where the receivables are margin loans, these will be regulated by relevant provisions of the Corporations Act 2001 (Cth) (“CA”) rather than the NCCPA and will be subject to their own disclosure, licensing and responsible lending regime.

(a) Various States and Territories had previous regimes limiting charges under regulated contracts. Under NCCPA changes a national regime will apply from 1 July 2013, under which:

- restrictive charging provisions will apply to small amount credit contracts; and
- a general cap of 48 per cent will apply to credit contracts, calculated as provided in the NCCPA.

(b) There is no express statutory right to demand payment of default interest under statute in Australia. However, this is a commonly accepted contractual term and, subject to meeting certain requirements, is not prohibited. Default interest is permitted under the NCCPA if it is only imposed on an event of default, only in respect of the amount in default and only while that default continues. The right to default interest should also be clearly set out in the contract and the amount should not be so high as to constitute a penalty or be considered unconscionable or unfair.

(c) Unless the contract prohibits its early repayment, a credit provider must accept early payments under NCCPA regulated contracts. The NCCPA also restricts early termination charges and obliges credit providers and lessors to consider applications for contract variation due to hardship (e.g. illness or unemployment).

(d) Consumer protection legislation (including the NCCPA), provides consumers with extensive rights and protections. Other key protections include:

- obligations relating to responsible lending, disclosure and contractual form; and
- consumer rights of contractual review, to have unfair terms declared void, to access external dispute resolution (“EDR”) schemes (which may have regard to “fairness” generally rather than strict legal obligations, and cannot be appealed) or to have a court reopen an unjust transaction.

#### 1.3 Government Receivables

Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

The application of relevant rules to contracting with government will depend on which “arm” of the “government” a party is contracting with (e.g. whether it is the Commonwealth or a state, and whether it is the Crown in the right of the Commonwealth or a state or a separate statutory corporation formed under federal or state law). Government contracts for receivables are generally subject to the same requirements and laws as contracts between other persons, but there can be some modifications in their application (for example, the powers of the Commonwealth are...
limited by the Constitution and a statutory corporation will only have the powers enumerated in its constituent statute). Other important points to note include:

- the parliament of the Commonwealth or a state or territory can pass laws that affect a contract it has previously entered into;
- enforcement against the Crown is subject to special procedures under Crown proceedings legislation;
- the payment of a debt owed by the Crown from government revenue must be authorised by legislation; and
- in very limited cases, executive necessity may allow the Crown to breach the contract without penalty on the basis of its public responsibility.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Australia that will determine the governing law of the contract?

In these circumstances, an Australian court will generally determine the governing law by:

- first, assessing whether, an implied choice of law can be inferred as a matter of contractual construction; and
- next, if no such implied choice of law can be inferred, by identifying the law with the closest and most real connection to the contract (having regard to factors such as the place of residence and business of the parties).

2.2 Base Case. If the seller and the obligor are both resident in Australia, and the transactions giving rise to the receivables and the payment of the receivables take place in Australia, and the seller and the obligor choose the law of Australia to govern the receivables contract, is there any reason why a court in Australia would not give effect to their choice of law?

Australian courts will generally give effect to an express choice of law, subject to that choice being bona fide, there not being a public policy reason for not giving effect to the choice of law, and to the choice of law not infringing any statute of the forum. Growing authority also suggests that the law chosen by the parties needs to have a substantial connection with the contract. On the facts of the base case, it is unlikely that any of the vitiating factors would apply.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Australia but the obligor is not, or if the obligor is resident in Australia but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Australia give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

See question 2.2. Australian courts will generally give effect to an express choice of foreign law subject to the exceptions noted. If questions of foreign law arise in Australian courts, the party asserting a particular effect of foreign law needs to prove that effect by providing expert evidence, and the Australian court treats the effect as a question of fact to be established by evidence.


Yes. Australia acceded to the Convention on 1 April 1989 and, as a consequence of implementing legislation, the Convention has the force of law and will generally prevail over local law to the extent of any inconsistency.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Australia’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Australia’s laws or foreign laws)?

There is no general rule in Australia that the sale of the receivables needs to be governed by the same law as the receivables themselves and, subject as noted under question 2.2, Australian courts will generally respect a choice of law. However, the law of the receivable is still relevant (for example, in construing the rights and obligations of the parties to the receivable contract).

The PPSA has separate conflict of law rules which are complex. Generally speaking, the PPSA applies to a transfer of receivables if the seller is located in Australia or if the receivable is an Account or Chattel Paper payable in Australia. One or both of these are satisfied in most Australian securitisations. If the PPSA applies then:

- perfection as against the debtor is governed by the PPSA rules (see question 4.2); and
- perfection as against third parties asserting a competing interest in the receivable is generally determined by the laws of the jurisdiction in which the seller is located. However, because of the complexity in this area, we expect practice to be that purchasers will register even if the seller is located outside Australia.

3.2 Example 1: If (a) the seller and the obligor are located in Australia, (b) the receivable is governed by the law of Australia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Australia to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Australia, will a court in Australia recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, as the seller is located in Australia (see question 3.1).

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Australia, will a court in Australia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

As the seller is located in Australia, Australian requirements will apply as discussed in question 3.1. However, the law of the obligor’s country may also be relevant, particularly if it has rules on how the obligation can be transferred.
3.4 Example 3: If (a) the seller is located in Australia but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Australia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Australia’s own sale requirements?

Same as the answer to question 3.3.

3.5 Example 4: If (a) the obligor is located in Australia but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Australia recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Australia’s own sale requirements?

No. If the obligor’s debt is payable in Australia, then Australian requirements will apply as discussed in question 3.1 in addition to the requirements of the seller’s country.

3.6 Example 5: If (a) the seller is located in Australia (irrespective of the obligor’s location), (b) the receivable is governed by the law of Australia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Australia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Australia and any third party creditor or insolvency administrator of any such obligor)?

No. As the seller is located in Australia, Australian requirements will apply as discussed in question 3.1.

4 Asset Sales

4.1 Sale Methods Generally. In Australia what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

In Australia a sale of receivables is generally by way of legal or equitable assignment.

Under a legal assignment, legal and equitable title pass to the purchaser, who becomes sole owner of the receivable. A legal assignment must be an absolute assignment in writing of the whole of a present debt, with written notice to the debtor.

Equitable assignments are more common in securitisation transactions, under which the purchaser obtains beneficial ownership of the receivable, but legal title remains with the seller. An equitable assignment requires valuable consideration and a clear intention to assign identifiable receivables and may have additional risks including that:

- the debtor may be fully discharged by paying the seller, and may exercise set-offs against the seller (notice to the debtor can overcome this);
- the seller may sell the same receivable to another purchaser (PPSA registration (see question 4.2) and otherwise notice to the debtor can overcome this); and
- the purchaser may need to join the seller in actions against the debtor.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Perfection is governed by property law statutes in the various Australian states and territories and by the rules of equity. In addition, the PPSA imposes separate but overlapping perfection rules where the receivables are “Accounts” or “Chattel Paper” under the PPSA, but this will be the case in most Australian securitisations.

“Perfection” in this context has two elements:

- obtaining the best interest against the debtor:
  - a legal assignment is fully perfected against the debtor and an equitable assignment can be perfected by notice to the debtor; and
  - under the PPSA, despite notice to the debtor, the debtor and the seller may modify the contract as it relates to payments that have not been fully earned by performance, but only if, amongst other things, this does not materially adversely affect a purchaser’s rights; and
- obtaining best interest against third parties:
  - the interest of an assignee of Accounts or Chattel Paper is a deemed security interest under the PPSA, which can be registered under the PPSA giving a priority based on registration time against other interest holders (including other purchasers);
  - failure to register under the PPSA does not invalidate the assignment as against the debtor or any insolvency official appointed to the debtor;
  - where the receivable is Chattel Paper, a promissory note or certain other negotiable instruments, a holder of the original instrument may have PPSA priority over other registered assignees; and
  - where the PPSA does not apply, notice of assignment to the debtor will generally give priority over other interested parties who have not yet given notice.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The general rules are set out in questions 4.1 and 4.2. However, each of these debt classes raises specific issues. For example:

- an assignment of promissory notes does not require PPSA perfection;
- an assignment of mortgage loans may require registration of land mortgage transfers on land titles registers;
assignment clauses in consumer loans can, in some cases, give rise to unfair contract terms issues; and
marketable debt securities sold through clearing systems are subject to the rules of the clearing system.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Notice of the assignment should be given to obligors as set out in questions 4.1 and 4.2.

If the receivables contract permits, or does not prohibit, an assignment, then obligor consent is not required.

If the contract prohibits assignment, but the receivable is an Account or Chattel Paper under the PPSA, then an assignment is valid regardless of lack of consent. However, the debtor may have contractual and tortious remedies arising out of contract breach.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

The notice can be delivered at any time. However, payments occurring, and competing interests arising, before the notice is given are not affected by such notice.

For a legal assignment, the notice must be in writing.

If the PPSA applies, the notice must comply with the content requirements set out in the PPSA.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Australia? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Australia recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

If the contract prohibits assignment, but the receivable is an Account or Chattel Paper under the PPSA, then an assignment is generally valid regardless of lack of consent. However, the debtor may have contractual and tortious remedies arising out of contract breach.

If the PPSA does not apply, a contractual restriction prohibiting assignment may mean that any assignment without consent is void.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must adequately identify the receivables to be sold such that, at any point in time, those receivables that are subject to the assignment can be distinguished from those that are not by reference to the wording of the sale document. However, provided that the class of receivable being transferred can be and is identified with adequate certainty to distinguish it from other receivables, this need not be achieved through listing each specific receivable. The receivables being sold do not need to share the same objective characteristics but it is quite common for receivables being sold to share specified “eligibility criteria”. A sale can generally be drafted to attach to all of the receivables of the seller, provided that “receivables” are sufficiently defined for these purposes, and a sale of all receivables other than specifically identified receivables (or adequately identified classes of receivables) can also generally be structured.

If receivables are secured by security over cars, ships, aircraft or certain intellectual property rights, then there may be benefits in registering that underlying security with respect to the serial number for those items.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intention that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The language of the contract should clearly and expressly be that of sale and the legal character of the right and obligations created by the terms of the contract should be consistent with that language. Australian courts are likely to look to the legal substance of the transaction rather than its economic substance. In particular, the court is likely to adopt a two-step analytical process:

- first, a determination of the rights and obligations the parties gave each other under the terms of the sale contract; and
- second, the characterisation of such rights and obligations as a matter of law (without regard to the intention of the parties).

The transaction must not be a “sham”. The parties must not disguise the transaction as a sale if the true nature of the rights and obligations intended by the parties are not those of a sale. Not all “retention” factors will undermine the characterisation as a sale. For example:

- it is common for the seller to act as servicer of the receivables;
- the purchase price may include variable or deferred elements; and
- the seller may provide indemnity protection for representations and warranties relating to the receivables.
In addition, a sale should not be recharacterised on the sole basis the seller has a right to repurchase the transferred receivables. However, a right of repurchase may increase the risk of recharacterisation if it exists in conjunction with other features which, taken together, suggest the creation of legal rights and obligations inconsistent with those of a sale.

Under the PPSA, a transfer of Accounts or Chattel Paper is generally treated as a security interest regardless of economic effect. However, if the transfer secures “payment of a performance or obligation”, then the proceeds are subject to a mandatory waterfall which requires residual proceeds to be returned to the seller after the secured obligation has been satisfied. While this provision has not been interpreted, it seems unlikely that this will apply unless the whole transaction is re-characterised as a secured loan.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, a present assignment of adequately identified future property for valuable consideration can be recognised in equity (but not at common law).

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Yes as per question 4.9. The sale should be for valuable consideration with the sale documentation including clear and unambiguous identification of the future receivables to be assigned. The assignment of the future receivables should occur automatically by the terms of the sale contract without any further act being required. If properly drafted, the receivable should vest in the purchaser immediately upon coming into existence. However, see question 6.5 for the situation where the purchaser has not paid the purchase price in full prior to the seller’s insolvency.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The formalities required for a legal assignment of related securities will depend on the type of related security involved. For example, a legal assignment of a real property mortgage will require the registration of a transfer of the mortgage on the relevant land titles register. Transfers of related securities regulated by the PPSA will need to be perfected by PPSA registration.

5 Security Issues

5.1 Back-up Security. Is it customary in Australia to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary to take “back-up” security to address the risk that the sale is deemed by a court not to have been perfected.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Australia, and for such security interest to be perfected?

The security interest will need to be perfected by PPSA registration. See question 5.3.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Australia to grant and perfect a security interest in purchased receivables governed by the laws of Australia and the related security?

The most common form of security is a general security interest over all assets of the purchaser. The security interest must be perfected by PPSA registration within prescribed time limits. It is possible to perfect security interests in some assets by possession or control only, with no registration, but this is unusual in the securitisation context.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Australia, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Australia or must additional steps be taken in Australia?

If the purchaser is an Australian company or an Australian registered foreign company, then the security interest must comply with Australian validity and perfection rules. Where the purchaser is not Australian or Australian registered, the Australian conflict of laws rules for intangible property are complex. In practice, most security interests over receivables governed by Australian law are taken so as to comply with validity and perfection requirements in Australia. See further section 3.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

As a general matter, there are no additional or different requirements except as noted in section 4.

5.6 Trusts. Does Australia recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Australia recognises trusts.
Collections trusts are commonly used in Australian securitisation transactions. Collection trusts and turnover trusts may be security interests under the PPSA, and it is common to register them.

5.7 Bank Accounts. Does Australia recognise escrow accounts? Can security be taken over a bank account located in Australia? If so, what is the typical method? Would courts in Australia recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Australia?

Escrow accounts are recognised in Australia, but are uncommon. It is more common for the purchaser to take security over the payment bank account.

Security is commonly taken over bank accounts under a security agreement by way of charge or mortgage and perfected by PPSA registration. Tripartite arrangements with the account bank are recommended.

Where the security holder is an Australian authorised-deposit taking institutions ("ADI") and it is taking security over an account for which it is account bank, it has absolute priority and registration is not required.

As a general rule, Australian courts will recognise and enforce foreign-law security over bank accounts in Australia. However, Australian rules for validity and perfection apply in most cases.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The secured party, or any receiver appointed by it, controls all cash from enforcement forward. However, if the secured party does not control the bank account for the purposes of the PPSA, then certain statutory preferred creditors may have priority rights to the bank account which can disrupt the secured party’s control of the cash.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, generally, as long as that is provided for in the terms of the security document.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Australia’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the sale of receivables is a true sale by way of legal assignment and has been perfected, a seller’s insolvency should not interfere with a purchaser’s rights in respect of the purchased receivables (subject to those matters discussed at question 6.3). If there has been a true sale but it is only by way of equitable assignment, the position may be more complex and practical issues may arise. If there is any doubt as to whether the assignment has been perfected, an administrator or liquidator of the seller may obtain an interim injunction from a court staying the enforcement by the purchaser of its rights pending judgment from the court as to whether the assignment has been perfected.

If the purchaser is deemed to be only a secured party (in the sense of holding a security interest such as a charge over the receivables) rather than the owner of the receivables, then, broadly, if the security interest:

- is a “circulating security interest”, it may in certain circumstances be void against the company’s liquidator;
- is not perfected, it will vest in the seller upon its going into administration or liquidation;
- is perfected by registration and by no other means and registration occurred within certain prescribed time periods, the interest will vest in the seller upon its going into administration or liquidation; and
- is perfected:
  - the purchaser will be bound by the statutory stay on enforcement during the administration of the seller; and
  - an administrator of the seller may be able to dispose of the receivables which are the subject of the security interest in the ordinary course of the seller’s business in certain circumstances.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

An insolvency official does not generally have the power to prohibit the purchaser’s exercise of rights in connection with an effective sale of receivables, other than in the circumstances discussed in questions 6.1 and 6.3. However, the insolvency official is not required to assist the purchaser where such assistance is necessary for the purchaser to exercise their rights.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Australia for (a) transactions between unrelated parties and (b) transactions between related parties?

If a transaction takes place within a specified “suspect” or “preference” period, a liquidator may be able to have the transaction set aside if it is a “voidable transaction”. In general terms, voidable transactions include unfair preferences while the company was insolvent, uncommercial transactions while the company was insolvent, unfair loans and unreasonable director related transactions. The suspect period depends on the type of voidable transaction (for example, it is generally six months from the commencement of administration or liquidation or unfair preferences, but this may be extended to either four years or 10 years in certain circumstances).
6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Assuming that the purchaser and the seller are separate and independent bodies, there is no statutory right or established Australian line of authority that would allow an insolvency official to consolidate their assets in insolvency proceedings. However, if the purchaser and the seller are related entities and/or their affairs are intermingled in a prescribed manner, it may be possible for a liquidator to obtain a pooling order or to make a pooling determination to permit the purchaser and the seller to be wound up on a pooled basis.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Australia, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) sales of receivables that only come into existence after the commencement of such proceedings?

Once certain insolvency proceedings have been commenced:
- no sale of receivables can occur unless the relevant insolvency official or the relevant Australian court consents;
- if the contract has been entered into but the purchase price has not been paid (or the purchaser has not otherwise acquired a proprietary interest in the receivables), the purchaser will have an unsecured claim against the seller with regard to any loss the purchaser suffers; and
- if there has been a true sale of future receivables, and the purchaser has paid the purchase price in full prior to the initiation of administration or liquidation, then (subject as discussed in questions 6.1 and 6.3) the seller’s insolvency alone will not affect the purchaser’s rights in relation to the receivables.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Australia establishing a legal framework for securitisation transactions? If so, what are the basics?

Although Australia does have a legislative framework for covered bonds, it does not have a specific legislative framework for securitisation. However, in the case of securitisations involving ADIs, APS 120 (a prudential standard specific to securitisation established by our prudential regulator) will apply. In addition, some Australian laws (such as stamp duty laws) make specific provision for securitisation in certain circumstances (for example, in the form of exemptions) and many laws of general application will impact a securitisation transaction.

7.2 Securitisation Entities. Does Australia have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Australia does not have a specific legislative framework for the establishment of special purpose entities for securitisation.

Securitisation vehicles are most commonly established in Australia as special purpose trusts (which are not legal entities separate from their trustee), but can also be established as special purpose companies.

7.3 Non-Recourse Clause. Will a court in Australia give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Australian courts should generally give effect to a clause limiting the recourse of parties to specified assets provided that the contract itself is enforceable (and, in the case of a contract governed by the foreign law, that contract and the limited recourse clause are enforceable as a matter of the foreign law). However, see question 1.2 and section 8 in relation to consumer contracts.

7.4 Non-Petition Clause. Will a court in Australia give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Australian courts should generally give effect to a clause prohibiting a creditor from taking legal action or commencing an insolvency proceeding (subject to the corresponding provisos in question 7.3). However, see question 1.2 and section 8 in relation to consumer contracts.

7.5 Priority of Payments “Waterfall”. Will a court in Australia give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, an Australian court should generally give effect to properly drafted contractual provisions which provide for the application of proceeds from the enforcement of security over the securitisation vehicle’s assets to the creditors bound by such provisions and entitled to such proceeds in a prescribed order (and, in the case of a foreign law governed waterfall, on the assumption that the waterfall is enforceable under the relevant foreign laws).

7.6 Independent Director. Will a court in Australia give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

As directors are under a duty to act in the best interests of a company and to prevent a company from insolvent trading, any contractual provision or provision in a company’s organisational documents prohibiting a director from taking specified actions could be contrary to those duties. As a general principle, Australian courts will not allow directors to act in accordance with such a provision where those actions would otherwise be inconsistent with their duties as directors. In exceptional circumstances, Australian courts have given effect to such provisions where they are subject to a “fiduciary out” allowing a director to act contrary to the provision if the actions of the director would be in breach of any duty owed to the company or unlawful.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Australia, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Australia? Does the answer to the preceding question change if the purchaser does business with other sellers in Australia?

The NCCPA (see question 1.2) applies if credit is provided in the course of a business of providing credit carried on in Australia or as part of, or incidentally to, any other business of the credit provider carried on in Australia (including where a person engages in conduct that is intended to induce people in Australia to use the goods or services of the person or is likely to have that effect whether or not the conduct would have that effect in other places as well).

Where credit is provided to consumers, certain persons (e.g. credit providers and lessors and persons exercising their rights or obligations), will require an Australian Credit Licence (“ACL”) unless an exemption applies. This, in the first instance, includes the purchaser where legal title is perfected, as the collection and enforcement of the receivables will be carrying on a business of being credit provider in Australia. An exemption is available to securitisation entities in certain circumstances if specified requirements are met and other exemptions may be available in particular circumstances.

As noted above, different requirements under the CA will apply if the receivables are margin loans.

In addition to the ACL requirements, an Australian financial services licence (“AFSL”) may be required by certain securitisation participants (e.g. trustees and trust managers) under the CA unless an exemption applies. This, the jurisdictional test in relation to AFSLs is similar to the NCCPA requirements and would likely be avoided on the basis that the only business carried on in Australia was in relation to receivables.

Further, the CA also requires a foreign company to be registered with ASIC if it will “carry on business in Australia”, which will depend on a number of factors including whether there is some repetition of commercial activities in Australia.

Where a foreign company has as its sole or principal business in Australia the borrowing or lending of money or has certain assets in Australia it may also have to register under data collection and reporting legislation.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

A servicer will be exercising the rights and obligations of a credit provider and will therefore require an ACL. This applies whether the servicer is an original or replacement servicer.

Certain Australian states and territories also have separate debt collection legislation which requires debt collectors to be registered or licensed in those jurisdictions.

The servicer may also require an AFSL if the receivables involve financial services regulated under the CA, including insurance or margin loans.

8.3 Data Protection. Does Australia have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Privacy Act 1988 (Cth) (“PA”) regulates how personal information can be collected, used and disclosed and imposes ongoing standards in relation to the information, including security and access obligations.

The PA only applies to information about individuals, but applies regardless of the consumer’s purpose in entering into the receivable. It extends to personal information about individuals collected in relation to a corporate customer (e.g. directors or employees).

Amendments to the PA have been passed and are due to commence in March 2014. These changes will require credit providers to review their systems, processes and customer consents to ensure that these are consistent with the amended Act.

Bankers also have a duty of secrecy to their customers which arises out of the relationship between banker and customer. This duty applies to both individuals and corporates.

In addition, an equitable duty of confidentiality applies to information of a confidential nature and unauthorised use or disclosure may constitute a breach of this duty. Contracts may also impose confidentiality obligations and a breach may result in a breach of contract.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Australia? Briefly, what is required?

The NCCPA will apply where a debtor or lessee is a relevant consumer. See further questions 1.2 and 8.1.

If the receivables are sold, the debtor will generally have the same rights against the purchaser as against the original credit provider for failures to comply with the contract disclosure and certain conduct and fee restrictions under the NCCPA.

Other relevant legislation includes various consumer protections such as:

- provisions making certain unfair contract terms void; and
- prohibitions against unconscionable conduct and misleading and deceptive conduct.

Rellevant legislation also contains “linked credit provider” provisions, under which credit providers and lessors can be responsible for the conduct of third parties (e.g. retailers) where the contract or lease has been entered into to finance goods or services offered by those third parties.

8.5 Currency Restrictions. Does Australia have laws restricting the exchange of Australia’s currency for other currencies or the making of payments in Australia’s currency to persons outside the country?

Foreign exchange is controlled by the Reserve Bank of Australia, which may at the direction of the Treasurer direct a person not to buy, borrow, sell, lend or exchange foreign currency in Australia or deal with foreign currency in any other way in Australia.

The approval or authorisation of the Minister for Foreign Affairs is required for certain transactions involving dealings with assets in

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connection with persons or entities linked to terrorist activities or certain proscribed countries.

Other regulations generally prohibit dealing with certain “designated persons or entities” by directly or indirectly making assets (including shares and securities) available to or for their benefit without a permit, and Australian anti-money laundering legislation prohibits the entering into of transactions with residents of prescribed foreign countries.

There are no per se exchange controls on the transfer of money out of Australia but reporting obligations may apply to certain transfers.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Australia? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Australia imposes withholding tax on, among other things, payments of interest or royalties from Australian residents to foreign resident recipients.

Whether Australian withholding tax will apply to payments, and the rate of withholding, will depend on:

- in the case of interest, whether the payments are interest, or in the nature of or in substitution for interest;
- in the case of royalties, whether the payment is regarded as a royalty for Australian tax (which may include payments for the use of intellectual property and commercial or scientific equipment or information); and
- the country where the recipient is located.

The default rate of interest withholding tax in Australia is 10 per cent and the default rate of royalty withholding tax in Australia is 30 per cent. The rate may be reduced if the recipient is resident in a country with which Australia has a double tax treaty and the treaty limits the rate of withholding tax. Some treaties reduce the rate to nil in the case of interest withholding tax and 5 per cent in the case of royalty withholding tax.

For certain underlying receivables (e.g. certain notes), an exemption from interest withholding tax may be available if the underlying issue satisfies the public offer test. There is no equivalent exemption for royalty withholding tax.

9.2 Seller Tax Accounting. Does Australia require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The Australian tax law does not require that a specific accounting standard be adopted for securitisation but Australian accounting policies adopted by an entity can impact on the Australian tax treatment of the entity’s income and outgoings in some situations. Specific provisions may apply to securitisation vehicles and in respect of financial transactions.

9.3 Stamp Duty, etc. Does Australia impose stamp duty or other documentary taxes on sales of receivables?

In Australia, stamp duty is imposed at the state and territory level on certain kinds of transactions or instruments. These stamp duty laws are not uniform in terms of which transactions or instruments are subject to duty, the rates of duty or the available exemptions and up to eight separate sets of stamp duty laws can apply to a transaction. Generally, the location of the receivables and, in some cases, the related securities will determine which stamp duty laws need to be considered.

Stamp duty issues that can arise in relation to a securitisation include those resulting from the transfer of receivables and the granting of security, although exemptions can apply (for which the exact structure and drafting can be important).

9.4 Value Added Taxes. Does Australia impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Good and Services Tax (“GST”) in Australia is imposed at the rate of 10 per cent of the GST-exclusive consideration for a taxable supply. The sale of receivables and related securities is not generally a taxable supply but the supply of collection agent services will generally be a taxable supply on which GST is payable by the supplier. In some circumstances, a securitisation vehicle may be entitled to claim back 75 per cent of the GST payable by the service provider if it is registered for GST.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Australian tax law empowers relevant taxing authorities to collect tax debts (whether or not related to the relevant transaction) and other amounts owing by a recalcitrant taxpayer from third parties. This power generally applies where the third party owes or may later owe money to the taxpayer. In these circumstances, the relevant taxing authority is generally empowered to require the third party to pay the money directly to the taxing authority instead of to the taxpayer.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Australia, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Australia?

The purchaser’s potential liability for Australian tax depends on its country of residence for tax purposes.

If the purchaser is resident in a country with which Australia has a double tax treaty, the purchaser should not be liable to Australian tax provided the purchaser does not have a permanent establishment in Australia. This may depend, amongst other things, on the terms of appointment of the seller as its agent in Australia. The terms of the treaty may also provide that particular income is taxable in Australia to a certain extent (e.g. withholding tax on interest).

If the purchaser is resident in a country with which Australia does not have a double tax treaty, the purchaser should only be liable for Australian tax on Australian sourced income. This is determined by reference to the nature of the income and relevant circumstances. In this respect, income that is subject to Australian withholding tax (e.g. interest) is not otherwise assessable in Australia.
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With the largest securitisation practice in the region, King & Wood Mallesons remains at the cutting-edge of new product development by financial institutions, investment banks and corporates. We have been involved in almost every landmark securitisation transaction in the Australian market and an increasing number in Asia.

The rate of regulatory and commercial change in the last two years has been remarkable. King & Wood Mallesons’ expertise in key disciplines, co-ordinated and collegiate approach to sharing of new information, capacity to efficiently analyse the complex issues in real time and deep relationships with key industry players cements the firm’s position as a leader in the Australian securitisation market.

Drawing on our deep understanding of the global capital markets and local conditions, including specialists based in Hong Kong, Beijing and London, and market leading position across the spectrum of capital markets work, our team is advising on some of the most significant transactions in Asia, including the first public consumer receivables securitisation in Singapore.
Chapter 8

Austria

Fellner Wratzfeld & Partners

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Austrian law does not require the fulfilment of any special formalities for receivable contracts. Such contracts can be entered into orally, in written form or even be implied based on the conduct of the parties, whereby written contracts are to be recommended for reasons of proof. An invoice alone does not constitute a contract but may evidence its existence. Behaviour of the parties can indicate intent of the parties to conclude a contract, but must indeed show a mutual intent to do so.

1.2 Consumer Protections. Do Austria’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

There are no specific limit rates of interest on consumer credit, loans or other kinds of receivables stipulated by law. However, there is a general limit resulting from the prohibition against contracts violating public policy. Under Austrian law, under which circumstances high interest rates violate public policy is a case-by-case analysis. Austrian law provides for a right of the creditor to claim interest on late payments. Unless agreed otherwise between the parties, the applicable interest rate stipulated by law applies. The statutory interest rate generally is four per cent p.a. for contracts and eight per cent p.a. over the base rate in case of claims arising out of contracts between companies in business transactions. There are no special legal entitlements allowing consumers to cancel receivables for a specified period of time. The legal venue for claims against consumers is always the competent court of their residence. Moreover, Austrian law has special consumer protection provisions concerning the permissible content of general terms and conditions, which are mandatory in nature.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

There is no special law regulating the sale or collection of receivables from governmental entities. Such entities, however, are treated differently than private sector firms with regard to non-assignment clauses. Under the Austrian General Civil Code (which includes governmental entities) (ABGB), non-assignment clauses in contracts between a public law corporate body or its subsidiaries on the one hand and an applicant for subsidies on the other are enforceable, whereas such clauses in agreements between private sector firms are not.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Austria that will determine the governing law of the contract?

Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I Regulation), which entered into force in all EU Member States, except for Denmark, on 17 December 2009, governs the choice of law in the European Union. It is based upon and replaces the Convention on the Law Applicable to Contractual Obligations 1980. Chapter I Article 4 of the Rome I Regulation regulates which law applies in case the parties to an agreement have not agreed which law applies, since receivable contracts are not listed in clause 1 of Article 4, the contract is governed by the national law according to the principles outlined above. In most cases this is the law of the obligor’s home country.
If the obligor is a customer within the meaning of the Consumer Protection Act (Konsumentenschutzgesetz), the choice of the law of a country that is not a European Economic Area Member State in some respects only applies to the extent it is more advantageous to the customer than the law of the European Economic Area Member State which would have applied without this choice of law. The restrictions on the permissible content of general terms and conditions apply to consumer contracts irrespective of the choice of law of the parties to such contract.

2.2 Base Case. If the seller and the obligor are both resident in Austria, and the transactions giving rise to the receivables and the payment of the receivables take place in Austria, and the seller and the obligor choose the law of Austria to govern the receivables contract, is there any reason why a court in Austria would not give effect to their choice of law?

No, there is no such reason.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Austria but the obligor is not, or if the obligor is resident in Austria but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Austria give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In general, the parties to a receivable contract are free to choose the applicable law. This freedom is restricted in cases where all parties to the receivable contract are resident in Austria and Austria is the place of performance. In such constellation, the mandatory provisions of Austrian laws must be applied to a receivable contract. In addition, foreign law will not be recognised to the extent it violates Austrian public policy. Furthermore, for contracts with Austrian consumers, see question 2.1.


Yes, it has been in force since 1 January 1989.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Austria’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Austria’s laws or foreign laws)?

The receivable contract and the contract out of which the receivables arise can be governed by different laws, irrespective of which law governs the receivables. The enforcement of receivables governed by Austrian law is subject to Austrian law.

3.2 Example 1: If (a) the seller and the obligor are located in Austria, (b) the receivable is governed by the law of Austria, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Austria to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Austria, will a court in Austria recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

A court in Austria will recognise the seller’s and the purchaser’s choice of the law of Austria irrespective of where the purchaser is resident.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Austria, will a court in Austria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Since there are no formal requirements for the transfer of receivables, an Austrian court will give effect to the parties’ choice of law.

3.4 Example 3: If (a) the seller is located in Austria but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Austria recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Austria’s own sale requirements?

An Austrian court will recognise such sale as being effective because under Austrian law there are no formal requirements for the transfer of receivables.

3.5 Example 4: If (a) the obligor is located in Austria but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Austria recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Austria’s own sale requirements?

An Austrian court will recognise such sale as being effective because, under Austrian law, there are no formal requirements for the transfer of receivables.
An Austrian court will recognise such sale as being effective because, under Austrian law, there are no formal requirements for the transfer of receivables.

4 Asset Sales

4.1 Sale Methods Generally. In Austria what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

There are no special formalities for the sale of receivables. The sole requirement is a mutual agreement between the seller and purchaser on the sale of the respective receivables. For reasons of proof, this agreement will normally be entered into in written form, which, however, is not mandatory under Austrian law. Furthermore, it is not necessary, for the effectiveness of the sale of the receivables, to inform the obligor of the sale. The obligor, however, is entitled to pay its debt to the seller and thereby discharge the debt until it has received notification of the sale. The customary terminology is that a seller sells receivables under a receivables purchase agreement to a purchaser, whereas in such agreements also the term assignment and corresponding terms are customary.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

As outlined in question 4.1, there are no specific formal requirements for the sale of receivables. A subsequent sale of receivables already sold is impossible under Austrian law since they have already been transferred to the first purchaser. For this reason, an acquisition in good faith generally is not possible although there are exceptions for sham transactions, acceptance bills and cheques. Nevertheless, if the obligor has not been informed of the first valid sale but only of the second invalid sale, it can pay to the second purchaser with a debt discharging effect. In such case, the first purchaser is entitled to a claim based on unjust enrichment against the second purchaser.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In Austria, promissory notes as certificates of debt are not securities but they are usually delivered physically in the course of the sale of the receivables. Mortgage loans are a form of security frequently used in Austria. Mortgages are accessory to the debt they secure and cannot be transferred without it. Mortgages must be registered with the land register to be legally valid. A mortgage can either be registered for a maximum amount or for the actual amount of a debt. In order to be registered with the land register, a mortgage for a maximum amount can only be transferred by notarised written agreement under acceptance of the obligor, which is why a receivable purchase contract, pursuant to which such mortgage shall be transferred, must comply with these formal requirements. Agreements on the transfer of other mortgages do not have to comply with these formal requirements.

Under the Consumer Credit Act (Verbraucherkreditgesetz), which implemented EU Directive 2008/48/EG into Austrian law, the consumer has to be informed if the consumer credit agreement itself or claims of the creditor arising therefrom are transferred to a third party, unless the original creditor, with the consent of the assignee, continuously acts as creditor in relation to the consumer. Although this provision is mandatory, its violation does not lead to the invalidity of the assignment.

The additional requirements for the sale and perfection of marketable securities differ depending on the type of security. Each transfer of ownership of securities requires a corresponding agreement between the seller and the purchaser. The transfer of bearer securities additionally requires either handing over of the securities to the purchaser or, as the case may be, instruction to the possessor to hold them in the future for the purchaser. Registered securities are transferred by way of assignment of the rights they certify. Endorsed securities have to be endorsed by the purchaser and transferred to its possession.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Under Austrian law, generally sales of receivables need not be notified to obligors nor be approved by them. To the contrary, sales of receivables between entrepreneurs concluded in the course of their business activities are valid even if the receivable contract between the seller and the obligor contains a non-assignment clause (for the exception concerning governmental entities, see question 1.3 above). Breach of a non-assignment clause, however, will subject the assignor to possible damage claims of the obligor. Such damage claims may not be set off against the assigned receivables and an assignee will not be liable only because it knew that a non-assignment clause had been in place between the seller and the obligor.
4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Under Austrian law, there is no need to give notice to obligors about a sale of receivables (see question 4.4).

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Austria? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Austria recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on assignment and sale stipulated in receivable contracts between entrepreneurs and consumers are enforceable and effective even against third parties. Non-assignment clauses in contracts between entrepreneurs concluded in the course of their business activities are not enforceable (see question 4.4). The seller will be liable to the obligor for the breach of an enforceable non-assignment clause and the obligor might withdraw from the contract or claim damages. A claim against the assignee is only possible in case of fraudulent conduct.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Under Austrian law, it is not necessary to specify the object of sale in detail, but it must be at least definable. For the specification of a concrete object of sale of a receivable purchase agreement, it is, however, advisable to give further details to avoid disputes between the seller and purchaser. Receivables to be sold in one receivable purchase agreement can originate from different kinds of contracts. The assignment of all existing and future receivables or the assignment of all of them with some explicitly mentioned exemptions is possible if the receivables are capable of being identified.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

None of these characteristics will hinder a sale’s perfection but the concrete form of the receivable contract defines whether only the economical ownership or both the economical and the legal ownership are transferred to the purchaser.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, a seller can sell future receivables (see question 4.7) if the receivables are capable of being identified.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

A seller in principle can sell future receivables that are capable of being identified (see question 4.9). With respect to an obligor’s insolvency, see question 6.5.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Depending on the type of security, additional formalities for their transfer might be necessary (see question 4.3). To ensure that no security becomes invalid by divergence of ownership of a security from the claim secured by it, receivable purchase agreements usually provide for the assignor to hold the securities in trust for the assignee until they can be legally effectively transferred to the assignee.

5 Security Issues

5.1 Back-up Security. Is it customary in Austria to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Taking a “back-up” security interest is not customary.
Austria

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Austria, and for such security interest to be perfected?

See question 5.1.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Austria to grant and perfect a security interest in purchased receivables governed by the laws of Austria and the related security?

The purchaser and seller have to enter into an assignment agreement on the granting of a security interest in receivables. To give legal effect to the granting of a security interest, it has to be shown in a way that enables third parties to take notice. This is usually effected via annotation in the purchaser’s books, whereas the security interest has to be shown in the respective customer account (Kundenkonto), as well as in the list of open invoices (Offene-Posten-Liste).

As long as the concrete amount of future receivables is not known to the purchaser, the remark in its books can be of a general nature, but it has to be individualised after the origination of a specific receivable.

To ensure the correct entry in the seller’s books, the purchaser should require inspection rights to avoid diverging annotations in the seller’s and the purchaser’s books. Failure to make correct entries results in the security interest not being perfected.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Austria, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Austria or must additional steps be taken in Austria?

Unlike contractual undertakings, a transfer in rem has to fulfil the formal requirements stipulated by Austrian law. The rules concerning the creation of a pledge, which is a right in rem, apply analogously to the granting of a security interest.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

See question 4.3.

5.6 Trusts. Does Austria recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, Austrian law recognises trusts.

5.7 Bank Accounts. Does Austria recognise escrow accounts? Can security be taken over a bank account located in Austria? If so, what is the typical method? Would courts in Austria recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Austria?

Escrow accounts in Austria or in a foreign country are recognised under Austrian law. Security over an Austrian bank account can be taken and is a customary form of collateralisation for banks. Under the general terms and conditions of banks, the borrower grants the bank a lien on all its objects and rights which enter into the bank’s possession, which in particular includes the credit on the borrowers’ bank account. An Austrian court would recognise a foreign grant of security over an Austrian bank account only if the formalities required by Austrian law are met.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

According to Austrian law, only the balance of the account as at the time of receipt of the third party notice by the garnishee can form the basis of enforcement. Cash flowing into the bank account after this point in time is not encumbered by the initial pledge of the bank account.

The secured party may only access the account’s balance by filing a petition to the court for pay-out of the balance.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The pledge is created with the service of the garnishment order to the garnishee. At this point in time, the owner of the pledged bank account has no access to the funds therein. As of the date of the creation of the pledge, the garnishee is not allowed to pay-out money from the pledged account to the owner (Zahlungsverbot) and the owner is not allowed to give instructions to the garnishee that interfere with the lien (Verfügungsverbot).

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, does Austria’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

There is no automatic stay under Austrian insolvency laws. Purchased receivables for which the purchase price has been fully paid and which have already been fully recovered cannot be claimed back by an insolvency administrator. If the receivables have not been sold to the purchaser, but it has a security interest in the receivables, the purchaser has a right of separate satisfaction in case of a seller’s insolvency.
6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the Insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

If contracts are not mutually fulfilled on or before the date insolvency proceedings are started, the insolvency administrator can choose between performance or non-performance of the contract. There are special rules for leases and employment contracts.

Certain transactions can be declared void as regards the creditors where a successful challenge is made by the administrator either by legal challenge or defeance under the Insolvency Act. The grounds for voidability are:

- **Discriminatory intent (Benachteiligungsabsicht).** This applies if the debtor acted with the intent to create a disadvantage for its creditors and the other contracting party: (i) either knew of this intent (up to ten years preceding the initiation of insolvency proceedings); or (ii) should have known of this intent (up to two years preceding the initiation of insolvency proceedings).

- **Squandering of assets (Vermögensverschleuderung).** A transaction can be challenged if it is seen as squandering the company’s assets. The other party to the transaction must have known or should have known that this was the case (up to one year preceding the initiation of insolvency proceedings).

- **Gifts made by the company (Schenkung).** Gifts made by the company can be challenged if made in the two years before the start of insolvency proceedings.

- **Preferential treatment of creditors (Begünstigungsabsicht).** Acts that favour one creditor over another can be set aside if they occurred in the 60 days before insolvency or after the start of insolvency proceedings.

- **Post-insolvency transaction.** Transactions taking place after insolvency can be declared void if the creditor knew or should have known about the insolvency (Kenntnis der Zahlungsunfähigkeit).

Any disposition of a company’s property by the debtor made after bankruptcy proceedings have started is void in proceedings without a debtor in possession since in such cases only the administrator is authorised to represent the debtor. In reorganisation proceedings with a debtor in possession, the debtor is entitled to carry on ordinary business activities, but needs the approval of the reorganisation administrator for extraordinary business activities.

Any impermissible divestment of the debtor’s property must be repaid to the insolvency estate. In case this is impossible, damages must be paid.

If third parties have become incontestably entitled to property which is to be restituted, the person, during whose possession the incontestable encumbrance of rights has taken place, must pay damages to the insolvency estate in case such person’s acquisition is contestable. In addition, the *bona fide* transferee of a gratuitous conveyance must provide for a restitution of assets only to the extent such transferee is enriched thereby; provided, however, that where such transferee’s acquisition of ownership also would be contestable in case of a non-gratuitous acquisition, the entirety of the assets that are the subject of the conveyance must be restituted.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Austria for (a) transactions between unrelated parties and (b) transactions between related parties?

See question 6.2.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

See question 6.2.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Austria, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

In Austria, both cases are treated the same but the consequences depend on the action taken by the insolvency administrator, as the administrator has the right to terminate the receivables purchase agreement.

If the administrator terminates the agreement and the receivables come into existence after the commencement of the insolvency proceedings, the purchaser has no valid title to the receivables and such receivables remain in the insolvency estate. If the administrator does not terminate the agreement, the consequences for the receivables are controversial under Austrian legal doctrines. It is not resolved whether the purchaser has the right to single out the receivables from the insolvency estate or whether the purchaser is only regarded as an unsecured creditor of the insolvency estate.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Austria establishing a legal framework for securitisation transactions? If so, what are the basics?

In Austria, there is no special securitisation law, but there are rules for special securitisation companies (*Verbriefungsspezialgesellschaften*) which can be established solely for the purpose of securitisation.

7.2 Securitisation Entities. Does Austria have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No, special securitisation companies under Austrian law do not differ from other companies except for the restriction that their sole business objective must be the execution of securitisation transactions. The company has to be structured in a way to allow
the separation of its own obligations from those of the originator, the legal and beneficial owners of which must be able to pledge and sell the rights connected therewith without restriction.

### 7.3 Non-Recourse Clause
Will a court in Austria give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

A non-recourse clause is effective unless agreed with a consumer.

### 7.4 Non-Petition Clause
Will a court in Austria give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Except for cases of willful misconduct or gross negligence, a clause prohibiting parties from taking legal actions against the purchaser or another person is legally effective.

### 7.5 Priority of Payments “Waterfall”
Will a court in Austria give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, an Austrian court will give effect to a contractual provision distribution payment to parties in a certain order specified in the contract, even where foreign law is applicable.

### 7.6 Independent Director
Will a court in Austria give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Such provision could only be effective between the parties but not in relation to third parties generally. A breach of a director’s contractual obligation not to commence an insolvency proceeding, however, is justified by mandatory law and therefore does not justify any claim for damages.

### 8 Regulatory Issues

#### 8.1 Required Authorisations, etc.
Assuming that the purchaser does no other business in Austria, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Austria? Does the answer to the preceding question change if the purchaser does business with other sellers in Austria?

A purchaser which only collects, enforces and securitises receivables will be qualified as a special securitisation company under Austrian law; such special securitisation companies cannot pursue banking activities, which would require a banking licence or other licences. If the purchaser on the other hand also provides other banking services, it would have to obtain a banking licence and to comply with the provisions concerning financial institutions.

The qualification as a special securitisation company solely depends on the purpose and organisation of a company but not on the number of its business partners.

### 8.2 Servicing
Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The business of collecting third parties’ receivables requires a business licence for the business of a debt collection agency. Debt collection agencies are not permitted to enforce third party claims before a court or to have claims assigned to them even if such assignment is only undertaken for the purpose of collection of the claims. Collecting agencies are only allowed to collect third party claims arising from claims in tort if the claims are undisputed. The acquisition of receivables from the delivery of goods or provision of services and the assumption of the risk of the collectability of such receivables and in connection therewith the collection of such receivables is a banking business with the meaning of the Banking Act (Bankweesengesetz) for which a banking licence is required.

#### 8.3 Data Protection
Does Austria have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

In Austria, the EU Data Protection Directive (95/46/EC) was implemented in the Data Protection Act 2000 (DSG), according to which the use of personal data of persons and companies is subject to several restrictions aimed at the protection of such data. As a general principle, the use of personal data is only permitted with the explicit consent of the concerned person. However, there is also a weighing of interests of the transferor of data and of the person whose data is affected. This weighing usually allows for the transfer of data in the course of securitisation transactions. In addition, there is a stricter protection of data of bank customers under bank secrecy provisions stipulated in the Banking Act. As with general data protection, banking secrecy can also be breached if the transferor’s interest in disclosing data outweighs the banking customer’s non-disclosure interest.

Both the general data protection rules and banking secrecy apply to the purchase of bank loans by special securitisation companies. Because of the weighing of interests, the disclosure of data to the extent absolutely necessary is generally viewed as permitted for the purpose of securitisation.

#### 8.4 Consumer Protection
If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Austria? Briefly, what is required?

Under the Consumer Protection Act (Verbraucherschutzgesetz) compliance with provisions of consumer protection is the sole responsibility of the seller. Since the validity of a receivable purchase contract may be affected by non-compliance with mandatory provisions of data protection, it is advisable for the purchaser to assure that these provisions are complied with, which typically is part of the representations and warranties package given by the seller.
8.5 Currency Restrictions. Does Austria have laws restricting the exchange of Austria’s currency for other currencies or the making of payments in Austria’s currency to persons outside the country?

Generally, there are no such rules under Austrian law, but the exchange into certain currencies can be restricted by resolutions of the United Nations or the European Union or by decree of the National Bank of Austria (Österreichische Nationalbank). Moreover, the exchange of currencies in certain circumstances must be notified to the National Bank of Austria for statistical purposes.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Austria? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments on receivables are generally not subject to withholding taxes in Austria.

9.2 Seller Tax Accounting. Does Austria require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

In Austria, there are no special accounting provisions concerning the securitisation of receivables.

9.3 Stamp Duty, etc. Does Austria impose stamp duty or other documentary taxes on sales of receivables?

Austria imposes stamp duty in different amounts on various types of written contracts. On assignment contracts, a stamp duty in the amount of 0.8 per cent of the consideration is imposed. Assignments between financial institutions and special securitisation companies are exempt from stamp duty. In some other cases (but not all), stamp duty may be able to be avoided by either concluding a contract in the form of an offer and its implied acceptance or, where one of the parties is a foreigner, by signing the document abroad and assuring that it is not brought into Austria.

9.4 Value Added Taxes. Does Austria impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

In Austria, value added tax is imposed on the sale of goods and provision of services in the amount of 20 per cent of the consideration. In case of a sale of receivables, the seller undertakes a tax-free turnover with monetary claims. Subject to provision of services by the purchaser to the seller, the purchaser has to pay value added tax, whereas the calculation basis is the difference between the purchase price for the receivables and the economic value of the receivables. This economic value is in particular in case of the sale of non-performing loans lower than the book value. The European Court of Justice decided in its decision C-93/10 of 27 October 2011 that the purchaser of receivables does not have to pay any value added tax in case he does not provide services to the seller since in such cases there is no taxable turnover.

If the purchaser is not situated in Austria, the obligation to pay the value added tax is shifted to the seller.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

All parties to an agreement are liable for the payment of stamp duty, if any. For value added tax, see question 9.4.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Austria, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Austria?

The purchase of receivables by a foreigner alone generally would not trigger any tax obligation of the purchaser except for stamp duty, if such arises.
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Fellner Wratzfeld & Partners (fwp) is one of Austria’s leading business law firms, combining in-depth legal expertise with well-founded business know-how and a hands-on approach in cutting-edge transactions, often completed under extreme time pressure. The firm’s clients include banks and other financial institutions, privately and publicly owned companies and public sector authorities. The firm’s expertise covers the full spectrum of industry sectors. The firm is particularly active in representing clients in the following sectors: banking and financing (including securitisations); service providers; infrastructure; oil and gas; as well as industrial manufacturers.

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The firm’s major fields of practice are M&A, Banking and Financing, Restructuring and Insolvency, Real Estate and Litigation/Arbitration. It also has a broad public law practice focusing in particular on public procurement, infrastructure projects (including environmental aspects) and construction law.
1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Contracts with a value greater than R$7,550 (approximately US$4,000) must be undertaken in writing. Although not required, it is advisable that contracts with a smaller value are also evidenced by a written agreement to facilitate its judicial enforcement.

In general, invoices alone are not sufficient to create a debt obligation. However, Brazilian law allows the provider of goods or services to issue a ‘duplicate’ of the invoice (‘duplicata’). The duplicata together with (i) a receipt issued by the debtor to the effect that a good or service has been received, and (ii) a protest issued in writing by a public notary stating that payment has not been received in due time, form a debt instrument that can be foreclosed in court.

In certain circumstances, the behaviour of the parties is sufficient for a receivable “contract” to be deemed to exist. Generally, these situations are based on the historic relationship between the parties or the standard market practice related to certain types of receivables.

1.2 Consumer Protections. Do Brazilian laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Interest rates can be freely contracted when at least one of the parties is a financial institution. That not being the case, there is a limit on interest rates charged by non-financial institutions that is equivalent to the rate charged by the government for late-payment of federal taxes.

Brazilian law provides a statutory right to interest on late payments, which corresponds to the rate charged by the government for late-payment of federal taxes. Such statutory rate applies unless the agreement or specific law provides otherwise. Penalties for late payments on consumer contracts are capped at 2 per cent.

Consumers may cancel a contract within a period of seven days from its signature or receipt of the good or service, whenever contracting products and services outside a shop (i.e. by internet or telephone). Upon cancelation, receivables are cancelled and any amount already paid by the consumer must be promptly returned with the corresponding monetary adjustments.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

The sale of receivables owned by the government or a government agency is a sale of public assets and therefore is subject to specific rules, which provide that government sales must be undertaken through a public auction in accordance with a procedure detailed by law (Federal Law No. 8.666, dated 21 June 1993).

Furthermore, restrictions are imposed by law on the level of indebtedness by the government and its agencies. Because of that, agreements for the sale of government receivables generally avoid provisions by which the seller accepts liability for non-performance of the assigned credits. The collection of receivables owned by the government or by a government agency must be pursued by the relevant entity rather than by the purchaser, via a special collection suit available only to the benefit of public entities. The purchaser may only collect the receivable directly against the obligor if the sale was formalised prior to the commencement of such collection.

In case the receivable is owned by a private seller and the government or government agency is the obligor, then the collection must be pursued in court, subject to the following specific rules, among others: (a) the claimant will not be entitled to attach or seize any obligor’s assets; (b) the final decision against the obligor will not be immediately enforceable; and (c) the judge will issue an order of payment, that will wait in line until all previous orders have been complied with (this could take years).

Since several exceptions to the rules above may apply in relation to government-originated credits, a case-by-case analysis is strongly advised.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Brazil that will determine the governing law of the contract?

According to Article 9 of Decree-Law No. 4.657/42, an obligation is governed by the law of the place of signature of the contract. If
the parties are not found in the same country at the moment the contract is formed, the contract is considered formed at the place where the last person to sign the agreement signed it. A different rule applies to contracts formally made of an offer to be accepted via a separate copy of the same instrument by the other party, in which case the law of the place of residence of the offeror prevails. Furthermore, there is jurisprudential authority to the effect that choice of law in violation of such provisions is not acceptable; this view has, however, not been upheld in recent cases and final resolution on this rule is still pending.

2.2 Base Case. If the seller and the obligor are both resident in Brazil, and the transactions giving rise to the receivables and the payment of the receivables take place in Brazil, and the seller and the obligor choose the law of Brazil to govern the receivables contract, is there any reason why a court in Brazil would not give effect to their choice of law?

No, Brazilian law will apply in this case.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Brazil but the obligor is not, or if the obligor is resident in Brazil but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Brazil give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

As noted in our answer to question 2.1 above, to the extent that the choice of law does not violate Article 9 of Decree-Law No. 4.657/42, a judicial court in Brazil will give effect to the choice of a foreign law (arbitral tribunals in Brazil, as opposed to judicial courts, are likely to always give effect to said choice).

However, foreign laws, foreign judicial decisions and arbitral awards based on foreign laws (either rendered in Brazil or abroad) will not be enforceable in Brazil in case they violate the Brazilian national sovereignty, public policy or morality.


No. The United Nations Convention on the International Sale of Goods is not in effect in Brazil. The Brazilian Senate has already approved legislation that internalises CISG into the Brazilian legal system, but the presidential sanction is still pending.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Brazilian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Brazilian laws or foreign laws)?

No. Brazilian law does not require the sale of receivables to be governed by the same law as the law governing the receivables themselves.

3.2 Example 1: If (a) the seller and the obligor are located in Brazil, (b) the receivable is governed by the law of Brazil, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Brazil to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Brazil, will a court in Brazil recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, provided that: (i) the receivables purchase agreement is executed in Brazil; or (ii) the agreement takes the form of a unilateral written offer made by the seller located in Brazil to be accepted via a separate copy of the same written instrument by the purchaser. The agreement shall be registered with the registry of titles and deeds of the domicile of the resident contracting parties to be effective against third parties.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Brazil, will a court in Brazil recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Yes, Brazilian courts will recognise that sale as effective against the seller and other third parties, notwithstanding the compliance with the foreign law. The obligor’s domicile is not relevant for the analysis. Regarding effectiveness against third parties please refer to question 3.2 above.

3.4 Example 3: If (a) the seller is located in Brazil but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Brazil recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Brazil’s own sale requirements?

Yes, but only if both the receivables and the receivables purchase agreement are executed in the obligor’s country. As noted in question 3.1 above, to the extent that the choice of law does not violate Article 9 of Decree-Law No. 4.657/42, a judicial court in Brazil will give effect to the choice of a foreign law. With respect to the enforceability of foreign laws, foreign judicial decisions and arbitral awards based on foreign laws please refer to question 2.3 above.

Regarding effectiveness against third parties please refer to question 3.2 above.
3.5 Example 4: If (a) the obligor is located in Brazil but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Brazil recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Brazil’s own sale requirements?

Yes, Brazilian courts will recognise the foreign sale as long as the receivables purchase agreement has been executed in seller’s country.

3.6 Example 5: If (a) the seller is located in Brazil (irrespective of the obligor’s location), (b) the receivable is governed by the law of Brazil, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Brazil recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Brazil and any third party creditor or insolvency administrator of any such obligor)?

As noted in our answer to question 2.1 above, to the extent that the choice of law does not violate Article 9 of Decree-Law No. 4.657/42, a judicial court in Brazil will give effect to the choice of a foreign law. In the described situation, the law of the purchaser’s country should be acceptable if: (i) the receivables purchase agreement is executed in the purchaser’s country; or (ii) the agreement took the form of a unilateral written offer made by the purchaser to be accepted via a separate copy of the same written instrument by the seller.

Regarding effectiveness against third parties, please refer to the registration requirement mentioned in question 3.2 above.

4 Asset Sales

4.1 Sale Methods Generally. In Brazil what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The most common method is to enter into an assignment of credit rights agreement, which is normally notified to the obligor and registered with a public notary. These procedures guarantee the effectiveness of the assignment against the obligor and third parties. The customary terminology is “assignment of credit rights” (contrato de cessão de crédito).

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In general, there are no formalities for a sale of receivables documented in writing to be valid between the parties. Except if otherwise provided under the receivables contract, no approval or authorisation by the obligor is necessary to render the sale valid and enforceable. However, the sale will only be enforceable against the obligor if the latter is notified about it.

The validity and enforceability against third parties depends on the register of the sale agreement with the registry of titles and deeds of the city of domicile of both parties.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

For promissory notes, transfer is made through endorsement – no other formalities of the kind mentioned in question 4.2 being required. For loans, which are normally evidenced by a written agreement other than a negotiable instrument of credit, the formalities are those described in question 4.2 above. Marketable debt securities, if properly registered with the Brazilian securities authorities and systems of clearance, can be freely sold in stock exchanges and/or over-the-counter markets.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Notice to the obligor is required for a sale to be effective against the obligor. Obligor’s consent is not required unless otherwise provided in the receivables contract (or if the contract prohibits assignment of the receivables). Notice to the obligor cuts off set-off rights with respect to obligor’s and seller’s liquid financial obligations with one another.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no general statutory requirements regarding the form of the notice or how it must be delivered if the receivables agreements may be regarded as debt and the transfer as a transfer of debt only (cessão de crédito). If the credit agreement indicates a specific form of notice or if there is any legal requirement for the specific type of credit, the same should be followed. There is no time limit to give notice to obligors. A notice of sale can be delivered after the sale and after insolvency proceedings against the obligor or the seller have commenced and it will only be effective after delivery. The effect is that if a debtor pays the original creditor (seller) prior to receiving the notice, the payment will be valid and the buyer will have no recourse against the obligor. Also, if the receivables are
provided as negotiable instruments, they may be assigned without any prior notice to the obligor, and will be valid against the obligor if the assignment (endosso) was performed in accordance with legal requirements for that particular type of negotiable instrument.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Brazil? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Brazil recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions in receivables contracts prohibiting the sale or assignment are enforceable in Brazil. There is no exception to this rule. The described sale will not be valid against the obligor and the seller will be liable for breach of contract before the obligor. Depending on the case, liability for damages can be sought by the obligor, the purchaser and creditors of the seller in addition to contractual penalties, if any.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

There is no statutory provision as to what type of information on each receivable is necessary for the sale to be valid, however, the sale document shall include sufficient information so that the receivables sold can be properly identified. Simply stating that seller sells all of its receivables, or all of the receivables owing by a certain obligor, is not sufficient identification of the receivables. Usually, it is common to indicate in respect to each receivable: the obligor’s name and taxpayer registration number; the date of execution of the receivables contract; and the invoice number and payment date. Assignment of future receivables usually makes reference to the commercial agreement that will give rise to the future receivables. Sale of real estate receivables shall also contain a reference to the relevant real estate.

Different kinds of receivables — sharing or not objective characteristics — can be sold under the same sale contract.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Brazilian law does not, as a rule, apply a substance-over-form approach in transaction analysis and as a result the parties are free to negotiate the terms of the sale without jeopardising perfection. However, in case the economic characteristics of the transaction completely deprive the sale from having effect, the transaction may be considered ‘simulated’ and thus void. The question is one of fact to be determined by a case-by-case analysis.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes. This is common in Brazil.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The seller can commit to sell receivables that come into existence after the date of the receivables purchase agreement in an enforceable manner. In fact, this has been recognised by the Brazilian Securities Commission (CVM), which, in 2006, issued regulations providing for a new type of receivables investment fund (fundo de investimento em direitos creditórios, or ‘FIDC’), called ‘non-standardised FIDC’. This new type of fund may securitise receivables which will come into existence after the date of the sale contract. With respect to the identification of future receivables in order to structure the sale in a valid and enforceable manner, please refer to question 4.7 above.

This analysis is altered after the insolvency of the seller is declared, since the administrator is vested with the power to terminate any agreement in case continuing to perform such agreement is not profitable for the bankrupt estate. As a result, in the case of bankruptcy there is discretionary room for a decision regarding the continued validity of the assignment agreement.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Except if provided otherwise in the agreement, the assignment of a credit includes the related security. As a rule, if there is no prohibition to the sale of the receivables, there shall be no prohibition in transferring the related security. However, it is necessary to notify the guarantor so that he/she/it is aware of the sale of the receivables and that he/she/it is now liable towards the assignee. It may also be necessary to take specific measures to document and register the assignment of the security depending on the nature of the security (e.g., if the collateral is a mortgage of a real estate, assignment must be registered at the relevant real estate registry).
5 Security Issues

5.1 Back-up Security. Is it customary in Brazil to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

This is not a regular feature in most transactions, but it can be negotiated between the parties. An alternative commonly used in Brazil as a means for the creation of back-up security is the assignment by a seller to the purchaser of a greater number of credits than the final value to be securitised, so that the excess will work as extra collateral.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Brazil, and for such security interest to be perfected?

A written clause in the agreement assigning the credits is recommended.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Brazil to grant and perfect a security interest in purchased receivables governed by the laws of Brazil and the related security?

If the security takes the form of a pledge, perfection would require a written agreement registered with a registry of titles and deeds of the place of residence of the pledgor and the pledgee, together with notification to the obligor of pledged receivables. In case the purchaser’s assets include real estate or real estate related receivables, registration of the lien with the competent real estate registry is also required.

Alternatively, the security might take the form of transfer of fiduciary ownership of the receivables. In this case, the purchaser recovers ownership upon payment of the debt. Here again, the lien is perfected through its registration with the registry of titles and deeds of the place of residence of the parties.

A new regulation has been issued to the effect that liens over deeds of the place of residence of the parties.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Brazil, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Brazil or must additional steps be taken in Brazil?

Brazilian law provides that the applicable law with regard to security interest in rem is the law of the domicile of the person in possession of the relevant asset. This rule is more easily adaptable to material assets. As to receivables, given that they are rights, the most sensible view is to consider that they are kept in the place where the creditor benefited by the pledge is resident. As a result, the terms of the collateral should follow the law of the country of such creditor. If they do not, the validity of the collateral might be impaired.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

As general rule, no relevant change applies.

5.6 Trusts. Does Brazil recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Brazil does not recognise trusts. However, an agreement may be executed in order to obligate the seller to keep collections received as a depositary, being responsible for the safeguarding and maintenance of such assets, for the benefit of the purchaser.

5.7 Bank Accounts. Does Brazil recognise escrow accounts? Can security be taken over a bank account located in Brazil? If so, what is the typical method? Would courts in Brazil recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Brazil?

Brazil recognises escrow accounts. Security can be taken over a bank account located in Brazil. In the typical case, security over bank accounts takes the form of a pledge over, or of a transfer of fiduciary ownership of, the credit rights owned by the account holder against the bank.

As mentioned in question 5.4 above, the applicable law with regard to in rem collateral is the law of the domicile of the person in possession of the asset. As a result, collateral over a bank account located in Brazil shall follow Brazilian law.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The general rule is the absence of limitations. Exceptions are enforcement limited by insolvency laws or similar procedures.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The security can be structured to allow – or not allow – the owner of the account to have access to the totality or part of the funds prior to enforcement.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Brazilian insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Brazilian bankruptcy law does not provide for an automatic stay. Notwithstanding, the insolvency official, any creditor or the Public Prosecutor’s Office may call the securitisation into question by filing a lawsuit seeking the revocation of the agreement or act (the so-called ‘revocation suit’). The plaintiff must prove that the aim of the contracting parties was to defraud creditors (i.e., fraudulent collusion between the seller and the debtor regarding the original debt or between the seller and the purchaser regarding the sale of the receivable) as well as that the bankrupt estate (i.e., formerly the seller) has suffered a loss or damage.

Brazilian bankruptcy law, however, protects bona fide investors in the case of credits subsequently securitised through the issue of bonds representing them, setting forth that the validity of the transfer shall not be impaired in case this would damage their rights. If the purchaser is deemed to be only a secured party rather than the owner of the receivables, then the purchaser will not be able to pursue the receivable against the original obligor or exercise any ownership right over the purchased receivable. The receivable will be part of the seller’s estate and collectable by the seller under the applicable insolvency proceedings rules; the purchaser may only collect and enforce the rights it may hold against the seller and in the context of the relevant insolvency proceeding. The sole exception is if the security created in favour of a purchaser is a contractual encumbrance called ‘alienação fiduciária em garantia’, which transfer to the purchaser the fiduciary ownership of the receivables.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

The insolvency official is not vested with the power to stop the agreements executed by the seller from having legal effects. The adequate means to prohibit the purchaser’s exercise of rights regarding a receivable that is otherwise perfected is to file a revocation suit.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Brazil for (a) transactions between unrelated parties and (b) transactions between related parties?

Under Brazilian law the “suspect” period is referred to as termo legal (literally, “legal term”). It is established by the bankruptcy judge in the bankruptcy decree and can retroact up to 90 days before the date of the bankruptcy request, of the judicial reorganisation request, or of the first formal protest for unpaid debts.

The following acts do not produce effects before the bankruptcy estate if they occur within such legal term, irrespectively of the existence of a fraudulent purpose or awareness of the contracting party about the financial and economic situation of the debtor: (i) the prepayment of debts; (ii) payment of matured and enforceable debts in any form other than in the one provided in the relevant contract; and (iii) formalisation of new in rem securities in respect to existing debts.

In addition to the above, gratuitous acts and waivers to inheritance or legacy that happened two (2) years before the bankruptcy decree are also ineffective before the bankruptcy estate.

There is no difference set forth by law regarding transactions between related and unrelated parties for such purpose.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

According to the Brazilian bankruptcy law, consolidation is not allowed. At most, the transaction may be declared ineffective in case it defrauds creditors.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Brazil, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

With relation to (a) and (b), at the very moment insolvency is decreed, the management of the company’s assets is transferred to the insolvency official. It will be up to the insolvency official, upon authorisation of the creditors committee, to decide whether to maintain or not the sales agreement.

In case a judicial reorganisation proceeding takes place instead of an insolvency proceeding, the company’s activities will not cease. In such hypothesis, the seller’s creditors are granted the power to deliberate on the transaction’s conditions for the receivables either in case (a) or (b).

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Brazil establishing a legal framework for securitisation transactions? If so, what are the basics?

Brazil has laws and regulations specifically providing for securitisation transactions.

The Brazilian Securities Commission (CVM) issued Instruction No. 356, dated 17 December 2001, establishing the legal framework of receivables funds (“FIDC”) used as conduit entities for securitisation purposes. On 8 December 2006 CVV issued Instruction No. 444 providing for ‘non-standardised’ FIDC, and allowing the securitisation of receivables that bear higher risks.

Apart from FIDCs, Brazilian law provides for other types of securitisation structures. The securitisation of real estate
receivables, for instance, can be undertaken through a ‘real estate credit securitisation company’ (‘companhia securitizadora de créditos imobiliários’), under Federal Law No. 9.514, dated 20 November 1997, or under a ‘real estate investment fund’ (‘fundo de investimento imobiliário’, or ‘FII’), under CVM Instruction No. 472, dated 31 October 2008. The securitisation of financial receivables are undertaken through a ‘financial credit securitisation company’ (‘companhia securitizadora de créditos financeiros’), under Resolution No. 2.686, dated 26 January 2000, from the Brazilian National Monetary Council. The securitisation of agribusiness receivables can be made through an ‘agribusiness securitisation company’ (‘companhia securitizadora de direitos crédito-agrícolas’), which is regulated under Federal Law No. 11.076, dated 30 December 2004.

Brazil has laws and regulations specifically providing for the establishment of special purpose entities for securitisation purposes. FIDCs and FIIs are investment vehicles for securitisation purposes that take the legal form of a joint-ownership (‘condomínio’). These are vehicles without legal personality. The formation of such funds requires an administrator, specially licensed and domiciled in Brazil (typically, a financial institution or broker-dealer, with a few other possibilities). Any person or legal entity can be an investor in a FII. As to FIDCs, investments are only permitted to qualified investors, as defined by CVM (financial institutions; insurance companies; pension funds; individuals or legal entities with financial investments greater than R$300,000 who declare in writing their condition of qualified investor; investment funds directed exclusively to qualified investors; and managers of portfolios and consultants in securities authorised by the CVM in relation to their own assets).

Agribusiness, real estate and financial receivables securitisation can be conducted by special purpose Brazilian corporations, the “companhias securitizadoras” mentioned in question 7.1. The requirements for the establishment of these corporations do not differ from the ones applicable to any other Brazilian corporation. Shareholders can be of any nationality but non-Brazilian resident ones must appoint a local attorney in fact. Management can be divided in two layers: an optional non-executive supervisory board (minimum of three individuals, resident or not in Brazil), and the executive directors (minimum of two individuals, all domiciled in Brazil).

Certain securitisation securities, such as Certificates of real estate receivables (certificados de recebíveis imobiliários or ‘CRIs’) and Certificates of agribusiness receivables (certificados de recebíveis do agronegócio or ‘CRA’) can only be issued by the “companhias securitizadoras”. There is no restriction on the status of a subscriber of CRI or CRA.

7.2 Securitisation Entities. Does Brazil have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

7.3 Non-Recourse Clause. Will a court in Brazil give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Assuming the contract’s choice of law is valid, courts in Brazil will give effect to such provision. However, courts in Brazil may limit the reach of this type of contractual provision in the case of fraud perpetrated against creditors.

7.4 Non-Petition Clause. Will a court in Brazil give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

According to the Brazilian Constitution no restriction or prohibition can limit one’s right to file any claim, petition or suit before any Brazilian court. This is a non-disposable right and will certainly prevail against the non-petition clause, even if such clause is grandfathered by a foreign law governing the relevant agreement.

7.5 Priority of Payments “Waterfall”. Will a court in Brazil give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes. Waterfall provisions are legal and common in securitisations in Brazil.

7.6 Independent Director. Will a court in Brazil give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Ordinarily, a Brazilian court will give effect to contractual provisions or provisions in a party’s organisational documents prohibiting the directors from taking specified actions without some other level of corporate approval (i.e.: the affirmative vote of an independent director; or approval by the shareholders), as long as the relevant action is not a duty of the directors under law. In respect to actions performed by the directors without the required approval, the company would have recourse against the directors but the Brazilian courts could moderate the effect of the contractual provision to preserve good faith third parties contracting with the company.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Brazil, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business in Brazil or to obtain any licence in Brazil? The answer is the same in the case that the purchaser does business with other sellers in Brazil.
8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

To enforce the collection of sold receivables, the seller or the replacement servicer will need to be empowered to act on behalf of the purchaser. Ordinarily, a contractual provision is included in the sale agreement for that purpose.

In case there is pending litigation, once the obligor has been served the initial summons for the collection and enforcement of the receivables, the replacement of the original claimant (either the seller, the purchaser or any third party such as a replacement servicer) by a new claimant will be subject to the obligor’s consent.

8.3 Data Protection. Does Brazil have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The use of consumer debtor information is restricted by general rules protecting intimacy and private life contained in the Brazilian Constitution as well as banking laws and regulations to the extent that the purchaser is professionally engaged in factoring or similar credit purchase activities. Such rules are not normally construed as restricting the use of obligor information, but only its unauthorised dissemination. In general, it is lawful to send credit protection agencies information on non-performing contracts or loans. The publication of information on non-compliant obligors, on the other hand, violates the rule.

The breadth of the mentioned rules would justify their application not only to the benefit of consumer obligors, but also to enterprises.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Brazil? Briefly, what is required?

Not in general, provided that: (i) the purchaser acquired only the receivables (as opposed to being assigned the receivables contract, including obligations towards the obligatory); and (ii) the receivables contract does not infringe any law. The sale of the receivables do not change the nature of the same. In view of that, some specific rules to the protection of consumers may affect the receivables (as opposed to being assigned the receivables contract, including obligations towards the obligatory) and not the purchased receivables. An example is the rule that allows prepayment at the initiative of the debtor, against (irrespectively of who the purchaser is). An example is the rule that allows prepayment at the initiative of the debtor, against proportional reduction of interest.

8.5 Currency Restrictions. Does Brazil have laws restricting the exchange of Brazilian currency for other currencies or the making of payments in Brazilian currency to persons outside the country?

There are presently no important restrictions on the exchange of Brazilian currency or on payments using Brazilian currency to foreigners. In practical terms, the unavailability of accounts in Brazilian currency outside the country is the major obstacle to make payments in Reais outside the country.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Brazil? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

There is no withholding when the obligor is an individual. Other than that, payments of receivables can be subject to various withholding taxes in Brazil, depending on the nature of the payments and the condition/residence of the purchaser and the seller. In view of the complexity of Brazilian withholding tax legislation, each transaction should be carefully analysed by a local tax expert.

9.2 Seller Tax Accounting. Does Brazil require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

There are regulatory rules providing guidelines as to how a securitisation transaction should be treated for accounting purposes, with potential tax repercussions as well. As a general guideline, the transaction’s economic essence is required to prevail over its legal form for accounting purposes. In general, the seller registers the transaction as a sale of assets at a loss (discount), whereas the purchaser registers the purchase of the asset and the respective gain is recognised along the term of the securitisation.

9.3 Stamp Duty, etc. Does Brazil impose stamp duty or other documentary taxes on sales of receivables?

There is no stamp duty or documentary taxes on the sale of receivables. Nevertheless, it may be necessary or convenient to register certain sales of receivables with public registries in Brazil so that they are enforceable against third parties. Registration duties are imposed on such registrations.

9.4 Value Added Taxes. Does Brazil impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Sales of goods and certain services are subject to VAT (ICMS), while other services not subject to VAT and expressly listed by the tax legislation are subject to a municipal service tax (ISS). Sales of receivables are not subject to value added taxes, sales tax or other similar taxes on sales of goods or services.

Fees paid by a Brazilian party to a renderer of collection services resident in Brazil shall be subject to the service tax (ISS), which is charged from the service renderer at a tax rate of up to 5 per cent, depending on the municipality where the services are rendered/Performed. In certain cases the contracting party (purchaser) may be liable for withholding and collecting the ISS. This service tax is not due on services exported to non-Brazilian residents (foreign purchaser), as long as the services’ results are verified out of Brazil (i.e. obligor/collection out of Brazil).

In case the collection agent is an individual resident in Brazil, fees received from the purchaser (if a Brazilian legal entity) would be subject to WHT at rates of up to 27.5 per cent. The purchaser would be liable for withholding and collecting this tax.
In the case of collection services rendered to a Brazilian purchaser by a non-Brazilian party, payments remitted abroad would be subject to (i) ISS at a rate of up to 5 per cent, depending on the municipality where the purchaser is located (due by the foreign service provider), (ii) WHT at a rate of 25 per cent (due by the foreign service provider), (iii) social contributions on gross revenues (PIS and COFINS) levied at a combined rate of 9.25 per cent, due by the Brazilian purchaser, and (iv) tax on foreign currency exchange transactions (IOF/Câmbio) at a rate of 0.38 per cent, due by the purchaser of foreign currency in remittances made overseas. Due to the form of calculating these taxes, the total effective tax burden can vary between 41 per cent to 59 per cent approximately, depending on whether the burdens of WHT and ISS are transferred to the Brazilian purchaser. The purchaser would be liable for the collection of these taxes, except for the IOF/Câmbio, which is to be withheld and collected by the financial institution that closes the foreign currency exchange transaction.

9.5 **Purchaser Liability.** If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Tax authorities cannot charge the purchaser for any taxes that have not been paid by the seller. If, however, the seller had tax liabilities and was insolvent when the receivables were sold, the transaction could be invalidated as a fraud against creditors.

9.6 **Doing Business.** Assuming that the purchaser conducts no other business in Brazil, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Brazil?

The mere ownership of the receivables, the acquisition of the same by an agreement executed out of Brazil, and the appointment of a collection agent does not render the foreign purchaser subject to Brazilian corporate taxation. On the other hand, Brazilian tax law provides that the maintenance of an agent or representative in Brazil with powers to negotiate contracts and bind their foreign principal can be characterised as a permanent establishment, therefore subjecting the foreign entity’s income to Brazilian corporate taxation. In view of this, the maintenance of an agent or representative in Brazil which purchases receivables contractually binding the foreign entity can trigger Brazilian corporate taxation of the foreign entity’s income under the same rules applicable to local entities (the actual tax burden may depend on particular circumstances).

Even if not considered “doing business” in Brazil, the purchaser may be subject to Brazilian taxation on specific transactions (i.e., income tax withheld at source, foreign exchange taxes, etc.).

**Note**

The information above is a general overview and not an exhaustive explanation on the matters discussed therein. It does not constitute legal advice, which shall be sought specifically with regard to any matter on a case-by-case basis.
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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) Certain consumer contracts or sales that are subject to the sale of goods legislation (sales involving personal property other than receivables and money) must be in writing in order to be enforceable.

(b) Invoices alone are sufficient to create a receivable, subject to the need to comply with consumer protection legislation, where applicable.

(c) A contract can be found to exist based on the behaviour of the parties and a written contract is not necessary to create a receivable, but would be helpful from an evidentiary perspective in case of a dispute.

1.2 Consumer Protections. Do Canada’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) The Criminal Code (Canada) makes it a criminal offence, subject to criminal sanctions, to charge interest at a rate greater than 60 per cent per annum. Interest is broadly defined to include fees and other amounts payable by the borrower to the lender and is determined on the basis of the actual annualised return realised by the lender, other than in cases of voluntary prepayments by the borrower. In commercial cases, courts have generally reduced the fees and other returns in excess of 60 per cent per annum to fall within the Criminal Code limits, rather than striking down all interest and fees altogether if there is a violation, where the commercial agreement so provides.

The Interest Act (Canada) prohibits charging an increased rate of interest on arrears of principal or interest that is secured by a real property mortgage.

Certain provinces also have consumer protection legislation that applies to lending transactions giving courts the ability to reduce the excessive cost of borrowing charges. Québec legislation provides that, in such case, the underlying contract may be terminated or the borrowing costs voided.

(b) There is generally no statutory right to interest on late payments in the common law provinces. The ability to charge interest must be supported by a contract. In Québec, there may, in certain circumstances, be a statutory right to interest for late payments.

(c) All provinces provide a cooling off period for direct sales contracts (contracts that are negotiated other than at the seller’s place of business). Certain provinces provide cooling off periods for various other types of consumer contracts as well.

(d) There is a wide array of ‘cost of borrowing’ laws in Canada. The failure to comply with the cost of borrowing disclosure may lead to an inability to enforce the resulting receivable. In addition, class action laws have been liberalised in Canada in the past decade to make it easier for representative plaintiffs to assert claims on behalf of a class of affected consumers.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Generally, receivables due from either the federal or a provincial government are not assignable unless certain procedural steps are taken under the Financial Administration Act (Canada) or analogous applicable provincial legislation. Receivables due from government agencies may, or may not, be assignable and assignability must be determined on a case-by-case basis. Certain tax rebates may be assigned under the Tax Rebate Discounting Act (Canada) or analogous applicable provincial legislation if prescribed procedures are followed.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Canada that will determine the governing law of the contract?

Canadian courts would apply principles of private international law in determining the law of the contract. Factors to be considered include the domicile, residence, nationality or jurisdiction of incorporation of the parties, the place where the contract was concluded and the place where delivery of goods or services is to be performed.
As a practical matter, foreign law must be proven by expert evidence in Canadian courts. Therefore, if an action on a contract without an express choice of law is brought in a Canadian court, and the court assumes jurisdiction over the matter due to a sufficient connection with the matter, it is likely that the court would be willing to interpret the contract under the laws of the forum unless the issue was disputed and expert evidence of the foreign law was introduced.

2.2 Base Case. If the seller and the obligor are both resident in Canada, and the transactions giving rise to the receivables and the payment of the receivables take place in Canada, and the seller and the obligor choose the law of Canada to govern the receivables contract, is there any reason why a court in Canada would not give effect to their choice of law?

It should be noted that matters of contract law fall under provincial jurisdiction. Therefore, on the basis that this question can be read as relating to a particular province of Canada, the answer is that the court would give effect to a choice of the law of that province, subject to the qualifications listed under question 2.3.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Canada but the obligor is not, or if the obligor is resident in Canada but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Canada give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such that between the seller and the obligor under the receivables contract?

A court would recognise the choice of foreign law in an agreement provided that the parties’ choice of foreign law was bona fide and there was no reason for avoiding the choice on the grounds of public policy. Notwithstanding the parties’ choice of law, a court:

(a) will not take judicial notice of the provisions of the foreign law but will apply such provisions only if they are pleaded and proven by expert testimony;
(b) will apply the law of the forum that would be characterised as procedural;
(c) will apply provisions of the law of the forum that have overriding effect (for example, certain enforcement provisions of the Personal Property Security Act (PPSA) in the common law jurisdictions would take priority over inconsistent remedy provisions in a security agreement governed by a foreign law) or, in Québec, that are applicable by reason of their particular object;
(d) will not apply any foreign law if such application would be characterised as a direct or indirect enforcement of a foreign revenue, expropriatory or penal law or if its application would be contrary to public policy of the forum; and
(e) will not enforce the performance of any obligation that is illegal under the laws of any jurisdiction in which the obligation is to be performed.


Yes, it is.

3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Canada’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Canada’s laws or foreign laws)?

No. The parties to the receivables purchase agreement would be free to choose a different law than that governing the receivables themselves. See question 2.3.

3.2 Example 1: If (a) the seller and the obligor are located in Canada, (b) the receivable is governed by the law of Canada, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Canada to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Canada, will a court in Canada recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

On the basis that this question can be read as relating to a particular province of Canada (see question 2.2) and subject to compliance with perfection requirements discussed under questions 4.2 and 4.4, a court in a province of Canada would recognise the effectiveness of the sale.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Canada, will a court in Canada recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

The answer would be the same as that for question 3.2, except that the effectiveness of the assignment against the foreign obligor would be governed by the law of the jurisdiction where the obligor was located, not as described in question 4.4.

3.4 Example 3: If (a) the seller is located in Canada but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Canada recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Canada’s own sale requirements?

The sale would be recognised so long as the seller remains solvent, subject to the qualifications referred to in question 2.3. As a practical matter, in securitisations involving a Canadian seller, a true sale legal opinion is usually required and Canadian counsel would not be able to opine on the enforceability or the effect of a receivables purchase agreement governed by a foreign law. Also, in a bankruptcy proceeding in a Canadian court affecting the seller, it is possible that the court might recharacterise a sale under a foreign
law as constituting a secured loan under applicable Canadian law if the receivables purchase agreement would not also constitute a sale under applicable Canadian law.

3.5 Example 4: If (a) the obligor is located in Canada but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Canada recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Canada’s own sale requirements?

A court would recognise the sale under the law of the seller’s country, but this would not obviate the need to comply with the requirements set out in question 4.4 for the sale to be effective against obligors in Canada.

3.6 Example 5: If (a) the seller is located in Canada (irrespective of the obligor’s location), (b) the receivable is governed by the law of Canada, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Canada recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Canada and any third party creditor or insolvency administrator of any such obligor)?

The answer here is the same as for question 3.4, with the added requirement to comply with the procedures set out in question 4.4 for the sale to be effective against obligors in Canada.

4 Asset Sales

4.1 Sale Methods Generally. In Canada what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Typically, the sale would be effected pursuant to a receivables purchase agreement. The terms of the receivables purchase agreement would depend upon whether the commercial arrangement is a factoring (financing), a whole loan sale (where the seller retains no residual interest in the receivables sold) or a version typically used in a securitisation (where the seller is entitled to a deferred purchase price reflecting a residual interest in the receivables). There is no significance to the choice of terminology among sale, transfer or assignment.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In each of the common law provinces (all provinces other than Québec), perfection is governed by that province’s PPSA. Under the PPSA, an absolute transfer of receivables is deemed to be a security interest. In order for the transferee to take priority in those receivables as against third parties (such as subsequent good faith purchasers for value), the deemed security interest must be perfected, usually by registering a financing statement in the PPSA registry in the province where the assignor is located for the purposes of the PPSA.

In Québec, an assignment of receivables could be perfected by registration only if the receivables transferred constitute a “universality of claims”. If the receivables do not constitute a universality of claims, the assignment may be perfected with respect to Québec obligors only by means of actual notice of the assignment to such obligors. There is considerable uncertainty about what constitutes a universality, but it is generally accepted that a sale of all receivables of a particular type generated by the seller between two specified dates would constitute a universality of claims. It should be noted that the creation of a universality in this way prevents the random selection of Québec receivables for inclusion in a segregated pool of Canadian receivables; rather, the Québec receivables would normally be selected so as to constitute a universality of claims generated between two specified dates.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

A transfer of promissory notes is governed by the Bills of Exchange Act (Canada) which deals with the rights of holders in due course of a bill, note or cheque. While perfection of an assignment of promissory notes is still governed by applicable provincial PPSAs (that is, in order to perfect the assignment as against third parties, either registration or possession is required), most PPSAs expressly provide that the rights of holders in due course are not affected by provincial PPSAs. As a practical matter, in order to ensure that the purchaser of a promissory note has priority over other claimants (to ensure no one else can become a holder in due course), it will be necessary for the purchaser, or a custodian acting for the purchaser, to take and maintain possession or control.

Most provinces of Canada have enacted Securities Transfers Acts (STAs) that deal comprehensively with the transfer and holding of securities and interests in securities. This legislation is modelled after article 8 of the US Uniform Commercial Code.

In each of the common law provinces, an assignment of interests in real property (such as mortgages) is perfected by registering the assignment in the applicable land titles or land registry office. Usually, sellers anticipating the sale of mortgages by securitisation will arrange for their mortgages to be originated in the name of a licensed trust company as nominee, bare trustee and custodian for the benefit of the beneficial owner in order to obviate the need to reassign the mortgages for securitisation. When mortgages are not registered in the name of a custodian or nominee, registration of assignments is typically not made at the closing of the securitisation transaction where the assignor has an investment grade credit rating; instead, the assignor will deliver a power of attorney in registrable form, which may be used by the transferee to register mortgage assignments at a later date. Since these powers of attorney are coupled with an interest in the related mortgages, such powers of attorney would survive the bankruptcy of the grantor of the power (the assignor).

In Québec, claims under a mortgage (a loan secured by an immovable hypothec) constitute personal (movable) property and perfection is obtained in the same manner as for other receivables: that is, by registration at the personal property security register (and
not the land registry office) in the case of the universality of claims, or else by providing evidence of the assignment to the obligor. The assignment of the mortgage (hypothec) resulting from the assignment of the claims should be registered at the land registry office, however, failure to comply with said requirement would not render the sale ineffective against a trustee in bankruptcy of seller. There are no statutory provisions providing that an assignment of consumer loans be treated differently than other loans.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

In order for an assignment of a receivable to be effective against the obligor, the obligor must receive notice of the assignment. Until the obligor receives notice, it may discharge its obligations by making payment to the seller and also retain the benefit of all defences that may be asserted against the seller. Therefore, even where there is no need to notify obligors in order for the assignment to be effective, the benefit of providing notification is to cut off the benefit of defences that could arise in the future.

In order for an assignment to be effective against the seller and its creditors, it is generally not necessary to notify obligors so long as the assignment is perfected by registration. The only exception is for obligors residing in Quebec, where the assignment does not constitute a universality (see question 4.2).

A receivable that arises pursuant to a contract that does not expressly prohibit assignment is an assignable receivable (except where the obligor is the federal or a provincial government or certain agencies thereof). A receivable from a government obligor is not assignable unless specified procedures are followed under the Financial Administration Act (Canada) or applicable analogous provincial legislation.

Contractual restrictions on the assignment of receivables are not binding on third party assignees; hence an assignment of “non-assignable” receivables may be perfected (subject to the rights of an unnotified obligor discussed under question 4.6); however, an assignment of an undivided interest in a receivable (rather than the entire receivable) would remain subject to contractual restrictions.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no mandated requirements regarding the form of notice or delivery mechanism; however, the onus of proving delivery will rest upon the party asserting delivery was made. Obligors may be notified of the assignment of their receivables at any time; however, if the seller files for protection under the Companies’ Creditors Arrangement Act (Canada) (CCAA) or the Bankruptcy and Insolvency Act (Canada) (BIA), a judicial stay of proceedings would likely prohibit the purchaser from notifying obligors of the assignment of their receivables without first obtaining a court order permitting such notice to be given.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Canada? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Canada recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

An assignment of a non-assignable receivable (as opposed to an assignment of an undivided interest in the receivable) is binding as between the seller and purchaser; however, the obligor thereunder will be entitled to fully discharge its obligations by making a payment to the seller, and therefore such an assignment would still be subject to the seller’s insolvency risk. The obligor could maintain a cause of action against the purchaser for the tort of inducing the breach of contract.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

It is not necessary for the sale document to identify each specific receivable; however, it must contain a description of the receivables being sold sufficient to allow them to be identified as belonging to the class of receivables sold. This may be satisfied by a sale of all of a seller’s receivables, or all receivables sharing objective characteristics, or all receivables of the seller other than those owing from specifically identified obligors.

If a sale is of less than all of the receivables of a particular type, then the existence of shared objective characteristics that would permit identification of receivables as either being sold or not sold would affect the characterisation of such receivables as a universality in Quebec. See question 4.2.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; and/or (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

There is a risk of a court recharacterising a sale of receivables as a secured loan. True sale legal opinions are typically delivered in
Canadian securitisation transactions. The most important factor in determining whether there has been a true sale is the intention of the parties, as evidenced by the documents, communications and conduct of the parties. The most important indication of the intention that an arrangement is a secured loan is the existence of a right of the seller to require that the receivables sold be reassigned to it.

According to the only reported judicial decision in Canada that considered the issue of the recharacterisation of a sale in a securitisation context, the court listed the following factors, in addition to the intention of the parties, to be considered in determining whether a transaction constitutes a true sale:

(a) the transfer of ownership risk and the level of recourse;
(b) the ability to identify the assets sold;
(c) the ability to calculate the purchase price;
(d) whether the return to the purchaser will be more than its initial investment and a calculated yield on such investment;
(e) the right of the seller to retain surplus collections;
(f) the responsibilities for collection of the receivables; and
(g) the ability of the seller to extinguish the purchaser’s rights from sources other than the collection of the receivables.

Of these factors, it is likely that the only one that is determinative of the issue by itself is the presence of a right of redemption. In determining whether there is a right of redemption, the court merely looked to whether there was a contractual right of the seller to repurchase or redeem the purchased receivables and did not infer that there was one on the basis of an economic analysis of the transaction.

### 5 Security Issues

**5.1 Back-up Security. Is it customary in Canada to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?**

No. That may be interpreted as contrary to the intent of the parties to treat the transaction as a sale. In any event, so long as the assignment is perfected as an assignment, if it is recharacterised by a court as a secured financing, the perfected assignment will also constitute perfection of the security interest in common law provinces.

Under Québec law, the likelihood of recharacterisation is low, as the assignment of claims as security is no longer recognised. If the transaction is recharacterised, the sale would likely not constitute a movable hypothec without delivery.

**5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Canada, and for such security interest to be perfected?**

This is not applicable in common law provinces.

To the extent that Québec laws apply to the validity and perfection of such security, appropriate charging language and a charging amount in Canadian dollars would need to be included in the documentation so as to constitute a hypothec. A registration of the hypothec would also be necessary. Additional formalities for the granting of the hypothec might have to be followed if the secured obligations constitute titles of indebtedness such as notes.

**5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Canada to grant and perfect a security interest in purchased receivables governed by the laws of Canada and the related security?**

The purchaser would have to grant security by means of a written agreement, which (subject to question 2.3) need not be governed by the laws of a Canadian province. A security interest in receivables would attach when:

(a) value is given by the lender;
(b) the debtor has rights in the receivables or the power to transfer rights in the receivables to the lender; and
(c) the debtor has signed a security agreement that contains a description of the receivables sufficient to enable them to be identified.

Where the purchaser funds the purchase of receivables by issuing notes, it would ordinarily enter into a trust indenture with an indenture trustee acting for the noteholders and other secured parties.

Security interests securing the receivables transferred to the purchaser are assigned together with the receivables. Under the PPSCA, the registration of an assignment of a security interest by the secured party is optional; such registration is not necessary in order to maintain perfection of the original security interest. Since the originator is also normally appointed as the servicer of the receivables, it is rare to effect these registrations at the time of a securitisation. However, if a replacement servicer is appointed, such registrations would be effected by or on behalf of the purchaser at such time. Under the Québec Civil Code, the need to register an assignment of a security interest or other rights depends on the type of security interest or other rights involved.
creditors. The trust indenture would include the granting of a security interest over the receivables. In each of the above two cases, perfection would be achieved by registration under the applicable PPSA in common law provinces. To the extent that Québec law applies, it would also be necessary for the purchaser to enter into a hypothec.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Canada, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Canada or must additional steps be taken in Canada?

It will be recognised. Where the purchaser is located (or domiciled under Québec law) outside Canada, no additional steps are required. If the purchaser is located in a Canadian province, it would be necessary to perfect the security interest by registration. If the purchaser is domiciled in Québec, a hypothec will be required.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Refer to question 4.3.

5.6 Trusts. Does Canada recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

These types of trusts are recognised in common law provinces, not Québec. However, a trust cannot “deem” collections to be held separate and apart from the seller’s own assets if, in fact, they are commingled with the seller’s assets such that they may not be separately identified.

In Québec, a similar result would be achieved by appointing the seller as agent (mandatory) of the purchaser.

5.7 Bank Accounts. Does Canada recognise escrow accounts? Can security be taken over a bank account located in Canada? If so, what is the typical method? Would courts in Canada recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Canada?

Security can be granted over escrow accounts. The means for taking security depends upon the type of account. For simple bank accounts, perfection can be achieved by registration under the applicable PPSA or by obtaining a hypothec over the claim resulting from such bank account if the holder is domiciled in Québec. For securities accounts, it is necessary to take control over these accounts under the applicable STA in those provinces that have enacted STAs.

Courts in Canada would recognise a foreign law grant of security subject to provincial private international law rules governing the validity of security interests; however, procedural aspects of enforcing security would be governed by the law of the province where the account was located.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Where security over a bank account is properly enforced and is not subject to a stay of proceedings in connection with an insolvency filing by the grantor of security and is not subject to prior ranking liens or claims and the bank has agreed to do so, the bank will recognise the secured party as the person in control of the account and all proceeds flowing into it.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, they can.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Canada’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Under the restructuring provisions of the BIA, a stay of proceedings is automatic for a period of 30 days and may be renewed by court order for further 30-day periods (up to a maximum period of six months). Under the CCAA, an application to restructure normally includes an application for a stay order of unlimited duration which is normally granted by the court.

If there has been a true sale of receivables and the seller has been replaced as servicer by a replacement servicer and all obligors have been notified of the assignment prior to the filing under an insolvency proceeding, the stay would not affect the collection of such receivables. However, the stay could prevent a replacement servicer from being appointed or obligors from being notified until a court determines that the transaction constituted a sale of receivables rather than a secured financing.

If the sale was not a true sale and the purchaser is deemed to only be a secured creditor, the stay of proceedings would prohibit the purchaser from enforcing its rights as a secured creditor unless leave is obtained from the court.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Although a stay order under the CCAA is not automatic, it is almost always included as part of the application by the debtor company to initiate restructuring proceedings under that Act.
6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Canada for (a) transactions between unrelated parties and (b) transactions between related parties?

Numerous statutes may be relevant in connection with the insolvency of the seller (collectively, Insolvency Statutes), including the BIA, the CCAA, the Winding-up and Restructuring Act (Canada) and various provincial fraudulent preference and fraudulent conveyance statutes. Under the Insolvency Statutes, certain transactions by an originator may be overridden or set aside in certain circumstances, including the following:

- a transfer of property made with the intention of defeating or defrauding creditors or others of their claims against the seller;
- a transaction that is entered into by an insolvent seller (or a seller that knows that it is on the verge of insolvency):
  - with the intent to defeat or prejudice its creditors;
  - with a creditor with the intent to give that creditor preference over the other creditors of the seller; or
  - with a creditor and that has the effect of giving that creditor a preference over other creditors of the seller;
- a gratuitous conveyance made within three months immediately preceding the commencement of a winding-up proceeding;
- a contract, whereby creditors are injured or delayed, made by a seller who is unable to meet its engagements with a person who knows of that inability or who has probable cause for believing that such inability exists;
- a conveyance for consideration, whereby creditors are injured or obstructed, made by a seller who is unable to meet its engagements with a person ignorant of that inability and before that inability has become public, but within 30 days before the commencement of a winding-up proceeding; and
- a sale, deposit, pledge or transfer of any property by a seller in contemplation of insolvency by way of security for payment to any creditor whereby that creditor obtains or will obtain an unjust preference over other creditors.

The time periods noted above relate to third party dealings; such review periods are extended if the seller and purchaser are related parties. In addition, under the transfers at undervalue provisions of the BIA and CCAA, a court may review a disposition of property for which the consideration received by the seller is conspicuously less than the fair market value of the receivables sold by the seller who becomes an insolvent person or bankrupt.

Bulk sales legislation applies in certain provinces if there is a sale of tangible assets (such as leased autos or equipment) out of the ordinary course of business. Failure to comply with applicable bulk sales legislation could make the purchaser responsible for losses suffered by the creditors of the originator (up to the value of the transferred assets).

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

There are no express provisions for substantive consolidation under the Insolvency Statutes. Instead, the jurisdiction to order substantive consolidation rests under the general equitable jurisdiction of the court in insolvency proceedings. There are only a small number of Canadian court decisions with reasons for judgment dealing with substantive consolidation. Canadian courts have generally adopted the “balancing of prejudice” test from U.S. court decisions, whereby the court asks whether the creditors of the insolvent person will suffer greater prejudice in the absence of consolidation than the debtor (and any objecting creditors) will suffer from its imposition. Factors commonly referred to in determining the balancing of interests include the following:

- difficulty in segregating assets;
- presence of consolidated financial statements;
- profitability of consolidation at a single location;
- commingling of assets and business functions;
- unity of interests in ownerships;
- existence of inter-corporate loan guarantees; and
- transfer of assets without observance of corporate formalities.

Since substantive consolidation is an equitable remedy, the risk that it could be applied cannot be eliminated; however, to reduce the risk of substantive consolidation, a number of steps can be taken, including the following:

(a) the special purpose purchaser can be established as an “orphan” trust legally under the control of an arm’s-length trustee, with no beneficiary having a right to terminate the trust;
(b) if an intermediate special purpose entity that is wholly owned by the seller (to which the receivables would be sold before being sold again to the purchaser) is used, it can be required to have an independent director who would be required to approve any fundamental change (such as amalgamation, winding-up or sale of substantial assets of the intermediate special purpose entity); and
(c) the intermediate special purpose entity or the special purpose purchaser should be operationally separate from the seller through the following means:
  - it can have its own bank accounts to pay its liabilities;
  - it can have its own financial statements prepared;
  - its liabilities should not be guaranteed by the seller; and
  - it should hold itself out to third parties as a separate entity distinct from the seller.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Canada, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Both would be executory contracts that could be disclaimed by an Insolvency Official. Also, during a stay of proceedings under the CCAA or BIA, it is possible that the purchaser’s right to enforce the sale agreement will be stayed unless leave of the court is obtained to enforce its rights under the sale agreement.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Canada establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no such law in Canada. There is, however, special covered bond legislation.
7.2 Securitisation Entities. Does Canada have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Canada has no law specifically providing for securitisation special purpose entities. In Canada, the special purpose entity used to issue notes is typically a common law trust.

7.3 Non-Recourse Clause. Will a court in Canada give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

A properly drafted unambiguous non-recourse clause will be enforceable, even if it is governed by a foreign law. See question 2.3.

7.4 Non-Petition Clause. Will a court in Canada give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Such a clause is not likely to be enforceable as it is likely contrary to public policy.

7.5 Priority of Payments “Waterfall”. Will a court in Canada give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Generally, a court would give effect to such a contractual provision; however, where such a provision reduces a party’s rights under that provision as a result of that party’s insolvency, such reduction in rights may not be enforceable.

7.6 Independent Director. Will a court in Canada give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

An action taken by a corporation without the approval of an independent director in contravention of a contractual restriction not to do so would nevertheless be a valid corporate act so long as it was done within the constraints of the corporation’s constituting documents. The remedy of the contract counterparty would be an action for breach of contract.

A requirement in a corporation’s constituting documents, including in a unanimous shareholders’ agreement, to the effect that the corporation could not institute certain actions without an independent director’s approval should be effective to preclude such action from being validly taken without such approval.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Canada, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Canada? Does the answer to the preceding question change if the purchaser does business with other sellers in Canada?

Assuming that the purchaser is not a foreign bank, merely owning receivables does not in and of itself require registration. Servicing receivables through an agent similarly does not require registration. However, if the activities amount to carrying on a business, registration under extra-provincial registration statutes would be required in order to maintain an action on any of the receivables. The greater the number of sellers that a purchaser deals with from a particular province, the higher the probability that the purchaser’s activities would constitute carrying on a business. In order to avoid becoming subject to regulation in Canada, it would be advisable for the purchaser to limit its connections to Canada by ensuring, as much as possible, that the following occur:

(i) the decision to purchase the receivables is made outside Canada;
(ii) all negotiations relating to the purchase of the receivables are either conducted outside Canada or conducted by telephone communications during which all of the officers and employers of the purchaser participating in the communications are outside Canada;
(iii) the funding for the purchase of receivables occurs outside Canada; and
(iv) the purchaser executes and delivers its documentation relating to the purchase outside Canada.

Provided that the purchaser is not carrying on business in Canada, no licensing would be required nor would the purchaser become subject to regulation as a financial institution.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The need for the seller to be licensed would depend upon the nature of the sale and the nature of the receivables. Collection by a seller of receivables on behalf of a purchaser would not require additional licensing so long as the obligors are not notified of the assignment. If obligors are notified of the assignment and the seller continues to collect receivables on behalf of the purchaser, certain provinces have collection agency statutes that could apply to require the seller to become licensed as a collection agent. A third party replacement servicer could require a licence under applicable collection agency statutes unless it was exempt from the application of such statutes (as are most financial institutions).

The collection of certain types of receivables, such as mortgages, may require special licensing under mortgage broker legislation of certain provinces.
8.3 Data Protection. Does Canada have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes. The Personal Information Protection and Electronic Documents Act (PIPEDA) is federal legislation that governs the collection, use and disclosure of personal information of individuals. Certain provinces have also implemented privacy legislation. PIPEDA and provincial privacy legislation apply only to individuals, not to commercial enterprises.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Canada? Briefly, what is required?

Most consumer protection laws would apply at, or near, the time that the receivable is originated. These include; cost of borrowing disclosure laws, false advertising laws, and certain laws regulating motor vehicle dealers. To the extent these laws were not observed by the seller, this could provide the obligors with defences against the purchasers. To the extent that there are consumer protection laws that apply following origination, such as privacy laws, the purchaser, including a bank, would be required to comply. In Québec, the assignee of a consumer receivable will be jointly and severally liable with the assignor for the assignor’s obligations toward the consumer (subject to certain statutory monetary limitations).

8.5 Currency Restrictions. Does Canada have laws restricting the exchange of Canada’s currency for other currencies or the making of payments in Canada’s currency to persons outside the country?

No, it does not.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Canada? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Canada has now fully eliminated withholding tax on interest paid to arm’s-length lenders, other than participating debt interest. Therefore, Canadian receivables, other than those that produce lease or royalty payments and dividends, sold to a non-Canadian purchaser, will generally not be subject to Canadian withholding tax. However, due to concerns about a non-Canadian purchaser becoming subject to Canadian tax by virtue of carrying on business in Canada through the servicing of the Canadian receivables, it is more common for an intermediate Canadian special purpose entity to be established to purchase the Canadian receivables and for that special purpose entity to then issue an interest-bearing note to a non-Canadian investor.

Withholding tax of 25 per cent is generally exigible on most cross-border lease, royalty and dividend payments, subject to reduction through bilateral tax treaties.

9.2 Seller Tax Accounting. Does Canada require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Canadian taxpayers must calculate their income for Canadian tax purposes in accordance with Canadian generally accepted accounting principles (although there are a number of specific policies that permit tax treatment to be different than accounting treatment). All Canadian public companies now adopt International Financial Reporting Standards for fiscal years commencing on or after 1 January 2011. Specified rules exist in the Income Tax Act (Canada) for financial institutions (as defined) holding and disposing of “specified debt obligations” (as defined).

9.3 Stamp Duty, etc. Does Canada impose stamp duty or other documentary taxes on sales of receivables?

No, it does not.

9.4 Value Added Taxes. Does Canada impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The federal government imposes a goods and services tax (GST) and some provinces impose a provincial sales tax (PST) that is combined with GST into a blended harmonised sales tax (HST); certain provinces, including Québec, maintain their own PST (although Québec has indicated that it will adopt the HST on 1 January 2013). These taxes apply to the transfer of certain tangible assets, such as leased automobiles and equipment. Servicing fees are also subject to GST or HST. Generally, no GST or HST is applicable to receivables that are sold on a fully serviced basis, whereby the servicing component is an ancillary part of the receivables purchase price and no separate servicing fee is charged. Therefore, it is most common in Canada not to specify a separate servicing fee but instead to sell receivables on a fully serviced basis. However, if a replacement servicer is appointed, the replacement servicing fees would be subject to GST or HST. The GST rate is 5 per cent. The HST rate depends upon the applicable province. In Ontario it is 13 per cent and in Québec there is a combined GST and PST rate of 13.92 per cent.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

If a seller has failed to remit GST, HST or PST, failed to remit certain employee source deductions and employee and employer portions of Unemployment Insurance and Canada Pension Plan payments or failed to remit withholding taxes on payments to non-residents, the applicable tax authority may recover such taxes from the assets (or any realisation thereon) from a person who merely has a security interest in the assets on a super-priority basis. Where a true sale has occurred, assets are purchased from a seller selling in the ordinary course of business; tax liability of the seller does not attach to the purchased assets.
9.6 **Doing Business.** Assuming that the purchaser conducts no other business in Canada, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Canada?

The answer would depend upon the specific facts of each particular situation. It is possible that the appointment of the seller as servicer and collection agent or the enforcement of the receivables against the obligors could cause a non-Canadian purchaser to be considered to carry on business in Canada and to be liable to tax in Canada on that basis. As discussed above, due to the concern with a non-Canadian purchaser being considered to carry on business in Canada through the servicing of Canadian receivables, it is more common for an intermediate Canadian special purpose entity to be established to purchase the Canadian receivables and for that special purpose entity to then issue an interest bearing note to a non-Canadian investor.
1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) The general rule in Chile is that contracts are perfected merely by consent of the parties. Exceptionally, Chilean law requires certain formalities to be fulfilled for publicity, perfection and/or enforceability of certain contracts, the most common of which are to be granted in writing, recorded onto private or public deeds, registrations in public records, and/or the payment of certain taxes. Nevertheless, we recommend recording most contracts onto deeds, as the lack of written evidence of the same can bring forth certain evidentiary problems (limitations on witness depositions). In addition, Law No. 18,045 on the Securities Market provides that securitisation companies, in fulfilling their corporate purpose, may acquire, in general, transferable credits and rights that are evidenced in writing.

(b) Pursuant to Law No. 19,983 on the Enforceability of Invoices, invoices shall be enforceable by themselves, insofar as they meet the requirements established by said law.

(c) The Chilean Civil Procedure Code expressly lists out the forms of evidence that may be used in any civil litigation: (i) instruments or documents; (ii) witness depositions; (iii) ex parte confessions; (iv) personal inspection of the court; and (v) presumptions. Notwithstanding the limitations on witness depositions mentioned in letter (a) above, the parties’ behaviour may be admitted as a basis for a judicial presumption in connection with the existence of a receivable contract. A receivable contract can exist as a result of the mere consent of the parties, provided it is granted in writing (plus certain additional formalities) and it includes a non challengeable obligation to pay, to provide or to not provide (along with other requirements such as in case of payment obligations, the amount shall be determined therein or the arithmetic therein allows to specifically conclude the amount to be paid).

1.2 Consumer Protections. Do Chilean laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) In the context of cash credit transactions (among which we include discounts transactions of cash representative documents, since they are considered as cash), gratuity is not presumed, and therefore, unless otherwise established by law or contract, said transactions shall accrue ordinary interest, calculated over the principal. Law No. 18,010 on Cash Credit Operations establishes the maximum interest limit that can be agreed, that is, the “maximum conventional interest”, corresponding to 50 per cent of the ordinary interest in force at the time of the respective transaction. In turn, ordinary interest is the average interest rate charged by Chilean banks and financial institutions for transactions conducted in Chile and it is determined by the Central Bank. Transactions carried out by the Central Bank with financial institutions are exempted from this limitation. The sanction for establishing an interest rate above the legal threshold is that it will be reduced to ordinary interest. The Civil Code is consistent with these principles in establishing a threshold for interest rates in the mutuum or consumption loan contract, namely an additional half of the ordinary interest rate in force at the time of perfection of the contract. In the case of simple cash obligations, they shall only accrue interest when the parties have so agreed or if the law expressly so provides (an example of the latter is found in bills of exchange, which accrue interest as of their maturity pursuant to Law No. 18,092 on Bills of Exchange and Promissory Notes).

(b) There is no legal requirement in connection with late payment interest, unless expressly agreed by the parties in general and the natural accrual of interest up to the actual payment in cash credit transactions, as mentioned in letter (a) above.

(c) As mentioned in question 1.1(a) above, the general rule is that contracts are consensual, and thus there is no right or term during which the parties may retract their manifestation of intent for the purposes of rendering said contract without effect. As an exception, Law No. 19,496 on Consumer Protection establishes that in contracts delivered by electronic means, or those in which a party accepts an offer made in any remote form of communication, the consumer shall enjoy a term of 10 days during which it may unilaterally terminate the contract with no right to compensation for the other party, and, consistently, the latter shall return all sums paid or disbursed, with the exception of services that were actually rendered by the date of the retraction.
1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

In connection with the disposal of bonds and other public debt securities issued by the State, article 47 bis of Law Decree 1263 of the Ministry of Treasury establishes that said Ministry, in the supreme decree attached to the corresponding issuance of securities, shall indicate the applicable procedure to their transference, which may be specific or subject to the general rules. In this same vein, the Chilean Code of Commerce provides that the assignment of tradable public securities must be conducted in the manner determined by the laws that created said securities or the decree authorising their enforcement. As regards the judicial collection of securities against the state or its organs, we must determine whether the organ has legal personality (if this is the case, then the general procedural rules shall apply; if not, the collection proceedings will be instructed against the state subject to the rules on “State Treasury Litigation”).

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Chile that will determine the governing law of the contract?

Chile is governed by the principle of territoriality of the law, and thus domestic law governs all legal situations arising within the territory of Chile, whether between Chileans or foreigners. Parties’ consent prevails in the choice of law.

2.2 Base Case. If the seller and the obligor are both resident in Chile, and the transactions giving rise to the receivables and the payment of the receivables take place in Chile, and the seller and the obligor choose the law of Chile to govern the receivables contract, is there any reason why a court in Chile would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Chile but the obligor is not, or if the obligor is resident in Chile but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Chile give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In light of the principle of autonomy of intent, parties may choose a foreign law to govern their contractual relationship. The above notwithstanding, a Chilean court may set aside this contractual provision if it entails an affectation of national sovereignty, public order provisions and morality standards (which we do not foresee in the simple form of the case provided in this question).


Yes, with the express reservation that if any of the parties to a contract has its establishment in Chile, the CISG rules shall not apply in respect of the perfection, amendment or mutual termination of the sale contract or any offer, acceptance or other manifestation of intent, if they are not in writing.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Chilean law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Chilean laws or foreign laws)?

There is no legal requirement in that regard. General rules will apply. Although, if Chilean law would be the choice of law to rule the sale of receivables, one must take into account that receivables are formal documents defined under Chilean law, hence, the purported “receivable” shall meet such requirements in order to allow the sale of receivables regulation to be applicable.

3.2 Example 1: If (a) the seller and the obligor are located in Chile, (b) the receivable is governed by the law of Chile, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Chile to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Chile, will a court in Chile recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, the Chilean court would recognise the sale as being effective.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Chile, will a court in Chile recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

The Chilean court will apply Chilean law disregarding the foreign law.

3.4 Example 3: If (a) the seller is located in Chile but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Chile recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Chilean own sale requirements?

Yes, the court in Chile will recognise that sale as being effective against the seller and other third parties without the need to comply
with Chilean own sale requirements. Insolvency rules can be applicable (such as revocation of the sale when fraud damaging creditors would have occurred) since they are considered public order rules.

### 3.5 Example 4: If (a) the obligor is located in Chile but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Chile recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Chilean own sale requirements?

Same as the answer to question 3.4.

### 3.6 Example 5: If (a) the seller is located in Chile (irrespective of the obligor’s location), (b) the receivable is governed by the law of Chile, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Chile recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Chile and any third party creditor or insolvency administrator of any such obligor)?

Same as the answer to question 3.4.

### 4 Asset Sales

#### 4.1 Sale Methods Generally. In Chile what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Sales of receivables are typically conducted through the so-called assignment of credits.

#### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In spite of the fact that the memorialisation of a contract is sufficient for its validity vis-à-vis the seller and purchaser, the perfection of the assignment of credits in respect of the obligor and third parties shall depend on the nature of the credits.

The assignment of nominative credits requires the material conveyance of the title in which the credit is recorded and a notice sent to the obligor in connection with the assignment or its acceptance. In certain cases the debtor is reserved with the right to reserve its arguments of defence against the latter creditor (the assignor).

The Code of Commerce and other specific statutes govern the assignment of credits issued “to the order of the creditor” (as an opposite concept of “nominative credits”), and it is perfected via the endorsement of the title. The assignment of credits issued to the bearer does not require formalities other than the conveyance of the title between seller and purchaser.

Similarly, there are specific statutes (inter alia, Laws No. 18,045, No. 18,092, No. 19,281 on Housing Leases with Promises of Purchase) that establish particular mechanisms for the perfection of the assignment.

Finally, Law No. 18,045 establishes, in connection with the creation of separate patrimonies, that the assignment or transfereence of contracts, credits and rights, or their respective titles, will be enforceable vis-à-vis their corresponding obligors, as of the date of the deed containing the issuance of the securitised bond(s). As of that date, the obligors may not invoke defences but for their personal defences against the creditor.

#### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Pursuant to Law No. 18,092 the assignment of a promissory note, bill of exchange or cheque is carried out through the endorsement of the respective document in favour of the purchaser. In the context of consumption loans and mortgage loans, the obligor must be notified, with the exception of endorsable mortgage loans, in which case a written endorsement made in the margin, or on the back of a certified, endorsable copy of the respective public deed, will suffice. Finally, sales of tradable securities in the securities market shall also require the fulfilment of certain disclosure and registration obligations before the Superintendency of Securities and Insurance (“SVS”).

#### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

As mentioned in question 4.2 above, the assignment of nominative credits requires a notice to or the acceptance by the obligor, which notice is generally sent by the purchaser, since it has greater interest in holding a valid and enforceable title. However, the seller may also notify the obligor.

If the assignment of receivables is not forbidden but not expressly allowed either, the assignment must be performed pursuant to the rules indicated in question 4.2 above. If there is an explicit prohibition on the assignment, the prohibition prevails (in the sense that the obligor retains its right to validly pay to the original creditor and to base its non payment arguments based on the legal liaison with the original creditor). Nonetheless, and in respect of certain receivables (i.e., invoices), these prohibitions have no standing in our legal system.

Once the assignment has been perfected, whether it required a notice, acceptance, endorsement or the mere conveyance of the title, the assignment shall be binding upon the obligor and third parties, and the purchaser acquires the rights of the seller against the obligor.
4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective— for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

When referred to nominative credits and no expressed acceptance by the obligor is granted, the notice has to be given through the courts. That is why certain special rules have created other means in order to facilitate perfection of the assignment such as with the case of Law No. 19,983.

Generally speaking, there is no time limit associated with the notice or acceptance of a credit assignment, and in fact, notice is usually carried out after the corresponding assignment. However, and despite having perfected the assignment between seller and purchaser, as long as the obligor has not been notified, it shall be authorised to pay the credit to the seller, the credit may be subject to seizures by the seller’s creditors, and the purchaser shall have no direct collection claim against the obligor.

Notice applies to the assignment of specific nominative receivables. (Save for Law No. 18,045 in connection with the creation of separate patrimonies, where the assignment can be applicable to future receivable to be listed with the separate patrimonies deed.)

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Chile? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Chile recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

In case of nominative credits if there is an explicit prohibition on the assignment, the prohibition prevails (in the sense that the obligor retains its right to validly pay the original creditor and to base its non payment arguments based on the legal liaison with the original creditor). Nonetheless, and in respect of certain receivables these prohibitions have no standing in our legal system (i.e., in accordance to Law No. 19,983, it is forbidden that any agreement, provison or action of any nature limits, restricts or prohibits the free transaction of the credits included on invoices).

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

In order for an agreement to be valid it is necessary for its object to be determined or susceptible of determination. Although there is no general provision that requires the complete identification of each of the sold receivables or the type of information that is required in this regard, minimum information to allow the due identification of the assigned receivables is necessary. Particularly, Law No. 18,045 requires that the issuance agreement or the placement deeds, as applicable, include the identification or specification of the assets, agreements, credits and rights that shall comprise the separate patrimony, in attention to their nature. Furthermore, if the aforementioned deeds do not allow for their identification or specification, it shall be necessary to detail their main characteristics, degree of homogeneity, their number, the term in which they shall be acquired and any other references that the SIS requires, postponing their identification for future complementary deeds. In domestic securitisations a discussion has been held as to the degree of specification that needs to be included in the assignment deed. In certain cases deals have included only serial numbers which are backing further information that remains undisclosed to the public. Such criteria has not been challenged at the courts.

There is no general provision that requires assigned receivables to share objective characteristics among each other; however, Law No. 18,045 imposes a degree of homogeneity between the assets that shall form part of the separate patrimony and even in the event of substitution of assets, demanding that such substitute assets comply with similar characteristics as the assets that are replaced. A declaration in connection to the assignment of all receivables, regardless of their nature (whether same are nominative, to the order or to the bearer), without at least specifying the elements that allow for their determination, would not be considered sufficient and its validity may be challenged with sufficient grounds in our opinion.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The mere fact that the parties denominate their transaction as a sale and state their intent that it be a sale will not automatically be respected; a court could enquire into the economic characteristics of the transaction. Such could be contested before a court if the economic characteristics of the operation evidence the execution of a simulated agreement. Basically the economic characteristic of a sale that determines the presence of a sale is the price. In addition, such sale has to conduct to the right to transfer ownership over the receivables sold. Further, in order to challenge a purported sale not being such but in presence of a different agreement (for example, collateral or security agreement) the presence or absence of the elements of both type of agreements have to be considered. Although contractually the parties may alter the general rules and agree on special provisions (i.e.: generally the seller is liable for the existence of the credit at the time of the assignment, as well as with regards to the present and future solvency of the debtor only if it agrees on one or the other; the establishment of repurchase rights under specific cases), the economic characteristics of the operations may reveal a declared intention that is far from the real intention of the parties. We are of the opinion that the seller may retain full credit risk; control of collections of receivables; and a right (as long as it is a right in its full control) of repurchase/redemption without jeopardising perfection of the sale. If it were to retain the interest rate risk one would assume there is no intent to transfer ownership.
4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes it can, through a promise agreement which can be enforceable in nature.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Under common terms the sale of future goods is subject to the condition precedent of the existence of the goods. Once in existence the creditor can claim the enforcement of the sale, but does not prevail vis-à-vis third parties.

In domestic securitisation the sale of future flows is accepted as an asset class, and we have given the opinion that such creates a preference, although such criteria has not been challenged in the courts.

Regarding bankruptcy, see section 6.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The assignment of credits also entails the assignment of the related securities that were executed to secure their compliance. The methods customarily adopted depend upon the nature of the related security. Personal guarantees attached are typically confirmed by the guarantor.

5 Security Issues

5.1 Back-up Security. Is it customary in Chile to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

In Chile it is not customary to take on a “back-up” security interest, even when it could be perfectly agreed by the seller and purchaser. Nevertheless, every seller has the obligation of protecting (compensating) the purchaser with regard to the ownership and peaceful possession of the sold asset when a court ruling orders its complete or partial confiscation (warranty of title). It is relevant to mention that the seller may contractually waive this obligation.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Chile, and for such security interest to be perfected?

In the warranty of title mentioned in question 5.1: (i) the cause of the deprivation of property must be dated prior to the sale, although the parties may agree that such cause be prior or subsequent to the sale; and (ii) the purchaser must summon the seller for the latter to defend the former.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Chile to grant and perfect a security interest in purchased receivables governed by the laws of Chile and the related security?

Such security can be provided through a pledge with non conveyance. A public deed or equivalent must be granted and registration with the pledge registration must be executed in order to perfect the security right.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Chile, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Chile or must additional steps be taken in Chile?

No. The validity and perfection of the acts and agreements granted and executed abroad is generally acknowledged in Chile, although, for them to be executed in our country they must comply with the requirements that would have been observed should they have been perfected in Chile. The additional steps to be taken in Chile would be to perfect such security (such as those referred to in the previous answer).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

In addition to question 4.3 above, there are drafting, notice and registration requirements that must be complied with before public registries, within specific terms, depending on the nature or type of guarantee.

5.6 Trusts. Does Chile recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Other than for securitisation purposes (as explained in question 7.1 below) or in case of private or public funds, there is no general statute for trusts in Chile whereby assets are considered to be apart from the remaining patrimony of the owner.

5.7 Bank Accounts. Does Chile recognise escrow accounts? Can security be taken over a bank account located in Chile? If so, what is the typical method? Would courts in Chile recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Chile?

No, Chilean legislation does not recognise escrow accounts. Although contractually they are used, allowing therefore for the execution of a security, typically a pledge, over the banking accounts and the funds that are deposited in the same. The way it is structured it is to open the account in the name of creditors or agents who are mandated to conduct the flows in a certain manner.

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In turn, the security granted above such funds is a pledge. See question 5.4 regarding the acknowledgment in Chile of a security granted under foreign law.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Such enforcement is possible and the sole limitation would be the general rights of creditors based on insolvency laws (preferred creditors would prevail).

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The pledge does not prevent, in itself, the free use and disposal of the funds in the account, however, it is customary to set forth a ban applicable to the encumbrance, disposition, uses and limited investments as well as minimum balance amounts that shall be observed in specific dates, in order to prevent the deterioration of the security.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Chilean insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

In case a sale is perfect and the seller’s bankruptcy is declared, the seller is not automatically prevented from exercising its ownership over the validly acquired receivables.

The only way in which the receivables could return to the seller’s patrimony and, subsequently, to the administration of the insolvency official is through revocation actions exercised by the insolvency official or any creditor in connection to the assignment of the receivables, in the event that such assignment was performed damaging or defrauding the seller’s creditors.

In case the purchaser is a secured creditor and not the holder of the receivables, and in the event of the seller’s bankruptcy, said receivables shall be managed by the insolvency official.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

See question 6.1.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Chile for (a) transactions between unrelated parties and (b) transactions between related parties?

Regarding the common debtor, the following shall be subject to annulment: (i) gratuitous acts or agreements executed between 10 days prior to suspension of payments and up to the date of the bankruptcy declaration (term that may be extended up to 120 days if the act was executed with a relative); and (ii) lucrative acts or agreements executed at any time in which both parties are in bad faith, that is, having known the poor financial state of the bankrupt party (fraud). For these purposes, the law establishes that bad faith shall be presumed regarding the acts that are performed within the term elapsing between 10 days prior to the date of suspension of payments and the date of the bankruptcy declaration.

Regarding the qualified debtor (one that performs a commercial, industrial, agricultural or mining activity), the following acts shall not be enforceable against its creditors: (i) early payments, payment in kind or the execution of real guarantees to secure prior obligations, performed during the term elapsed between 10 days prior to the date of suspension of payments and up to the date of the bankruptcy declaration; (ii) lucrative acts executed between the date of suspension of payments up to the date of declaration of bankruptcy, when both parties have performed the same in bad faith; (iii) compensations performed as of the date of suspension of payments and up to the date of declaration of bankruptcy, regarding the receivables that have been acquired against the bankrupt party via assignment or endorsement; and (iv) mortgages which were registered subsequent to the date of suspension of payments and prior to the declaration of bankruptcy, with more than 15 days elapsing between the day of execution of the security and its registration, with the insolvency official having declared its unenforceability.

The actions to dispute the acts shall be subject to the statute of limitation within a term of two years, as of the date of execution of the corresponding act or agreement, and shall be suspended for up to two years as of the date of declaration of bankruptcy.

There is no specific rule regarding operations between related parties.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Such possibility is not considered by Chilean legislation. Revocation is the sole available remedy.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Chile, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

In bankruptcy proceedings the bankrupt defendant loses the management of its assets, entrusting the same to the insolvency official. Insolvency proceedings do not automatically trigger early
termination of binding agreements; hence, if a sale of receivables was enforceable against the debtor prior to insolvency, it remains the same after becoming insolvent. As to the future receivables please refer to previous responses.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Chile establishing a legal framework for securitisation transactions? If so, what are the basics?

Title XVIII “On Securitisation companies and the Issuance of Securitisation Debt Titles” of Law No. 18,045, establishes a regulatory framework for securitisation in Chile. It consists of a finance mechanism through which the creditor of a group of receivables, for financing reasons, assigns such receivables at a specific price to a securitisation company, which acquires them for itself in order to form a separate patrimony, different from its common patrimony. To finance the purchase, the securitisation company issues a securitised bond in the stock exchange, in consideration to the assets of the separated patrimony that has been formed.

Also, private funds laws are vehicles used to structure domestic securitisation programmes.

7.2 Securitisation Entities. Does Chile have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

(a) They must be incorporated as special share corporations with a capital that may not be inferior to 10,000 Unidades de Fomento (approximately USD 490,000), and its exclusive corporate purpose must be the acquisition of financial assets, rights over payment flows, the issuance of debt short or long term debt titles, and any other activity that is authorised by the SVS. They are subject to the existence authorisation and operational supervision of the SVS.

(b) The bankruptcy of securitisation companies only affects their common patrimony and shall not trigger the bankruptcy of the separated patrimonies that they have incorporated, only causing the liquidation of the latter.

(c) Their directors and shareholders are subject to the information duties with regards to the SVS, and in all matters that are not addressed by Law No. 18,045, securitisation companies are ruled by the general provisions applicable to share corporations.

7.3 Non-Recourse Clause. Will a court in Chile give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

Yes, it will.

7.4 Non-Petition Clause. Will a court in Chile give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

For (a) no, since it is a public order issue. For (b), it would be debatable since the commencing of insolvency proceeding is not exclusive to one creditor, hence, one could argue that such prohibition restricts the mere right of the prohibited creditor.

7.5 Priority of Payments “Waterfall”. Will a court in Chile give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, contractual subordination is accepted in Chilean law (Civil Code), although such law does not specify the applicability of the contractual subordination in case of insolvency proceedings.

7.6 Independent Director. Will a court in Chile give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

No, attributions of directors are public order rules.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Chile, will its purchase and ownership of its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Chile? Does the answer to the preceding question change if the purchaser does business with other sellers in Chile?

Generally, no. Certain securities intermediation activities require incorporation and operation pursuant to law, as well as registration before, and prior authorisation from, the SVS or the Superintendence of Banks and Financial Institutions. In any event Chilean laws will be applicable since the source of income remains in Chile.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Such will follow the same principles explained in question 8.1, if the entity has to be licensed, such licence entitles to follow with the collection procedures, if not, such party will follow collection procedures with no additional requirement, which also counts for the replacement servicer.
8.3 Data Protection. Does Chile have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes, Law No. 19,628 on the Protection of Private Life, only applicable to personal data of individuals and not of any kind of legal entities, sets out that the treatment of private data can only take place when said treatment is authorised by law or the holder of the respective data.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Chile? Briefly, what is required?

In the event that the obligors fall within the meaning of consumers pursuant to Law No. 19,496, there may be ascribed certain rights and obligations to both parties. As regards the supplier’s obligations, it is possible to highlight those regarding its duty to make available to the consumer truthful, correct, clear and appropriate information in respect of the respective good or service, even before the execution of the relevant legal act and up to the termination of the obligation assumed. As regards obligations assumed in connection with borrowings, the supplier shall send to the consumer on a quarterly basis all information pertaining said obligation, and it shall also be bound to deliver that information every time the consumer so requires.

8.5 Currency Restrictions. Does Chile have laws restricting the exchange of Chilean currency for other currencies or the making of payments in Chilean currency to persons outside the country?

No restriction applies for such purposes.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Chile? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments abroad may be subject to withholding taxes in Chile, depending on the nature of the payments and the purchaser’s and seller’s place of residence. The withholding rate ranges between 0 per cent and 35 per cent, depending on the payment cause and the existence of an agreement to avoid double taxation with the country of residence and the country of the payee. In light of the complexity of the Chilean legislation’s withholding tax, each transaction must be thoroughly analysed from a tax perspective.

9.2 Seller Tax Accounting. Does Chile require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

From an accounting point of view, the securitisation transactions’ recording is based upon the IFRS accounting principles. Pursuant to tax law, the general provisions set out in the Income Tax Law govern purchases of credits in the context of a securitisation process. However, if the credit is acquired by a Chilean company which engages in securitisation transactions, the difference between the securitised credit’s acquisition value and par value is not deemed as income, but only the result obtained when comparing the duly corrected credit’s acquisition cost with the cost of its partial or complete recovery charged when said credit is collected, or its sale place if the same is sold.

Furthermore, when within the context of a securitisation process a Chilean taxpayer levied with the corporate tax assigns or promises to assign all or a part of the “payment flows” generated after the assignment date, covering more than one fiscal year in connection with sales or services, the special provisions of Chilean Income Tax law shall apply.

9.3 Stamp Duty, etc. Does Chile impose stamp duty or other documentary taxes on sales of receivables?

The Chilean stamp tax levies all documents containing a credit transaction. In case the seller’s purchase or assignement of accounts receivable falls within the meaning of “discount transaction”, the stamp tax shall be levied upon the respective contract. In case of other credits, an assessment of the foregoing must be carried out (the assignment of invoices does not constitute a credit transaction). As regards credit transactions coming from abroad, the documentary nature of the taxable event is not required.

9.4 Value Added Taxes. Does Chile impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The value added tax (“VAT”) does not levy the sale of intangible assets; therefore, the assignment of credits is exempted from this duty. Nor are collection fees levied with VAT, unless the service is rendered by a bank (in Chile, banking services are levied with VAT). Fees charged for administration and custody of assets comprising a separate group of assets, paid by Chilean companies engaged in securitisation transactions are exempted from VAT.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

With respect to VAT, the “service provider” is the person liable for VAT, having the obligation to levy VAT upon the respective transaction amount and pay the levied duty to the state taxing authority within the first 12 days of the month following that on which the transaction took place.

As regards the stamp tax, the law provides for different scenarios depending on the person liable for said tax in each case, but said condition is not transferred with the assignment of the credit. If a person intervenes in the taxable event in the capacity of agent or representative of someone, said agent or representative shall be joint and severally responsible for the payment of this tax.
9.6 Doing Business. Assuming that the purchaser conducts no other business in Chile, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Chile?

No, provided that the purchaser does not have domicile or reside in Chile, and does not constitute a permanent establishment therein. Treaties to avoid double taxation subscribed by Chile broaden the concept even to encompass cases in which foreign personnel is transferred to Chile to render professional or similar services for a specific period of time, or to act through a dependant agent, who does not act within the ordinary scope of his activity, and with whom conditions other than those agreed by an independent agent are agreed upon or imposed.

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Chapter 12

China

King & Wood Mallesons

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

According to the General Principles of the Civil Law of the Peoples’ Republic of China (“PRC”), a debt obligation could be created by a contract. Generally speaking, the PRC laws do not mandatorily request the sales of goods or services to be evidenced by a formal receivables contract, instead, the PRC Contract Law allows a contract to be concluded in writing (including formal written contract, letter or electronic communications), oral or other forms. Such general principle is subject to certain exceptions created by other laws, for instance, the PRC Property Rights Law requests formal written contract for the transfer rights of use of land.

In the PRC, invoices shall be produced in standard format and used for tax purposes only. An invoice alone is insufficient to evidence the conclusion of an enforceable debt obligation of the obligor to the seller, unless it is coupled with other evidences, such as communications between the parties and conduct of the parties.

A receivable “contract” may be deemed to exist as a result of the behaviour of the parties, provided that such behaviour covers the performance of major obligations by the seller and the acceptance by the obligor in respect of the seller’s such performance.

1.2 Consumer Protections. Do PRC laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) Limit of Rates of Interest

PRC laws do not limit rates of interest on loans denominated in currencies other than RMB, the lawful currency of the PRC. Commercial banks are able to freely negotiate the interest rate of foreign exchange loans with its borrower.

The interest rates of RMB loans extended by commercial banks are regulated by the Peoples’ Bank of China (“PBOC”). The PBOC will, from time to time, issue benchmark interest rates of RMB loans for different tenors, as well as minimum interest rates for different types of loans. Except for those RMB loans between financial institutions, whose interest rates could be freely decided by the financial institutions involved, the commercial banks can only adopt the interest rates equal to, or higher, than the applicable minimum interest rate. Since October 2004, the commercial banks are not subject to ceilings of interest rates for RMB loans.

According to the General Principles of Loan issued by PBOC in 1996, entities other than commercial banks and other financial institutions approved by the banking regulator, are not allowed to extend a loan in the PRC. However, PRC law does not prohibit private lending involving individuals, either acting as lenders or borrowers. The interest rates of such private lending are not subject to PBOC’s regulatory requirements imposed on commercial banks, but according to an interpretation issued by the PRC’s Supreme Court on 2 July 1991, it shall not exceed four times the rate applied by commercial banks generally for the same type of loan.

(b) Interest on Late Payment

According to the PBOC’s Rules on Interest Rate of RMB Loan, the late repayment of a RMB loan borrowed from commercial banks shall be subject to the default rate, which could be varied from 130 per cent to 150 per cent of the interest rate as stipulated in relevant RMB loan agreement.

Other than the default rate applicable to RMB loans granted by commercial banks, there is no statutory right to interest on late payment in the PRC. However, as general principles created by the PRC Contract Law: (i) the parties are allowed to agree on interest on late payment in contract, provided that such interest on late payment is not excessively higher than the actual loss suffered by the non-defaulting party, otherwise the defaulting party may apply to the people’s court or arbitration tribunal for adjustment; and (ii) where there is no agreement regarding interest of late payment, the non-defaulting party is allowed to claim for compensation caused by such late payment through the people’s court or arbitration tribunal.

(c) Consumer’s Rights to Cancel Receivables for a Specified Period of Time

The PRC Consumer Protection Law does not vest the consumers with a right to cancel receivables for a specified period of time. However, there are some provincial level consumer protection rules and regulations applicable to specific marketing methods that impose “cooling-off” periods for the benefit of consumers that would enable consumers to withdraw from their commitment to transactions that they have previously entered into, for example:

(i) Pursuant to the Regulations on Direct Marketing issued by the State Council in 2005, where the consumer purchases goods under a “direct marketing”, namely purchase the goods from the sales
person directly hired by the manufacturer, the consumer is entitled to return the goods and get the purchase price refunded within 30 days after the purchase, provided that the goods have not been unpacked.

(ii) Pursuant to Shanghai’s local rules regarding consumer protection, if the consumer purchases goods under a door-to-door marketing, the consumer is entitled to return the goods and get the purchase price refunded within seven days after the purchase without any reasons.

(d) Other Noteworthy Rights of Consumers regarding Receivables

It is noteworthy that, the seller’s rights to claim for consumer’s payment of receivables would be subject to the statutory limit generally applicable to all civil rights, for instance, under an international sale of goods, if the seller fails to claim for the consumer’s payment of purchase price within four years after due date, such receivables would not be protected by the people’s court anymore.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the PRC that will determine the governing law of the contract?

In the absence of choice of law in a receivables contract, the main principles for determining the governing law will differentiate for domestic transactions or foreign-related transactions.

If the transaction is a purely domestic transaction, PRC law could be the only governing law to the contract.

If the transaction is a foreign-related transaction, according to the PRC Laws on Governing Laws of Foreign-related Civil Relationships effective from 2011, the governing law can be determined based on the principles of “country of the party with characteristic performance” and “country most closely connected”.

No. There is no reason why a PRC court would not give effect to the parties’ choice of law under such circumstances.

2.2 Base Case. If the seller and the obligor are both resident in the PRC, and the transactions giving rise to the receivables and the payment of the receivables take place in the PRC, and the seller and the obligor choose the law of the PRC to govern the receivables contract, is there any reason why a court in the PRC would not give effect to their choice of law?

Pursuant to the PRC Laws on Governing Laws of Foreign-related Civil Relationships and the Supreme Court’s interpretation thereto issued in 2012, the above situation would enable the receivables contract to be deemed as a contract with a “foreign element”, and the PRC’s court would generally give effect to the choice of foreign law.

The above general principle will not apply under the following circumstances:

(a) the PRC laws have mandatory principles of law for this type of contract. For instance, a contract in respect of real estate shall be governed by the laws where the real estate is located, and a Sino-foreign joint venture contract shall be mandatorily governed by PRC laws, etc.; and

(b) choosing foreign law as governing law will jeopardise the public interest of the PRC, in which case the PRC law shall be the governing law.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in the PRC but the obligor is not, or if the obligor is resident in the PRC but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the PRC give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

No, PRC law does not require the sale of receivables to be governed by the same law as the law governing the receivables themselves.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does PRC law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., PRC laws or foreign laws)?

No, PRC law does not require the sale of receivables to be governed by the same law as the law governing the receivables themselves.

3.2 Example 1: If (a) the seller and the obligor are located in the PRC, (b) the receivable is governed by the law of PRC, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of PRC to govern the receivables purchase agreement, and (e) the sale complies with the requirements of PRC, will a court in the PRC recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Due to the foreign exchange control in the PRC, a PRC seller is not able to sell the receivables generated from a PRC obligor to an offshore purchaser.
Purely from the choice of law perspective, a PRC court would recognise the choice of PRC law to the receivables purchase agreement (“RPA”).

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside PRC, will a court in the PRC recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

A PRC court recognises the choice of PRC law and recognises the sale as being effective against the seller, the obligor and other third parties, provided that the relevant requirements under the PRC law for the sale have been complied with.

The foreign law requirements of the obligor’s country or the purchaser’s country (or both) may apply with respect to enforcement actions against the obligor or the purchaser, as applicable.

3.4 Example 3: If (a) the seller is located in the PRC but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in the PRC recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with PRC’s own sale requirements?

The principles regarding the recognition of the choice of foreign law governing the sale of the receivables, as discussed in questions 2.3 and 3.1, will apply.

Assuming the sale is effective against to the seller and other third parties in the PRC pursuant to its governing law, a PRC court will recognise the sale as being effective against the seller and such other third parties, provided that:

(a) mandatory rules and requirements under PRC law must be complied with if, and to the extent that, they are applicable. For instance, due to foreign exchange control, the seller may be subject to the authenticity verification imposed by foreign exchange authorities for its sale of receivables to the purchaser; and

(b) when bringing enforcement actions against the seller before a PRC’s court, the rules regarding enforcement of foreign court judgment or arbitration awards will apply.

3.5 Example 4: If (a) the obligor is located in the PRC but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in the PRC recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with China’s own sale requirements?

If the obligor is located in the PRC, as stated in question 3.2, due to the foreign exchange control in the PRC, a PRC seller is not able to sell the receivables generated from a PRC obligor to an offshore purchaser.

If the obligor is located in a country other than the PRC, see question 3.4 above.

4 Asset Sales

4.1 Sale Methods Generally. In the PRC what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology — is it called a sale, transfer, assignment or something else?

The sale of receivables is deemed as an assignment of contract rights under the PRC’s Contract Law. The PRC Contract Law stipulates that a creditor may assign its rights under a contract to a third party, subject to any transfer restrictions contained in the original contract or otherwise stated in PRC law.

The customary terminology in the PRC for sale of receivables is assignment.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

A sale of receivables will generally be deemed as completed between the seller and purchaser upon the execution of RPA. Pursuant to the PRC Contract Law, the assignment of contract rights by a creditor will become effective against the obligor once a notice of assignment has been serviced to the obligor.

PRC laws do not request additional or other formalities for the sale of receivables to be perfected against any subsequent good faith purchasers. Although PBOC has established an online registration system for pledge of account receivables, which also opens for registration of sale of receivables, such sale of receivables registration has not been vested with a public announcement function by law to claim against bona fide third party purchasers. It is notable that, where the sale of receivables involves transfer of security interest attached to the assigned receivables, answers to questions 4.3 and 4.11 will apply. Moreover, where the receivables are generated under a cross-border transaction, or the sale of receivables cause conversion of RMB to foreign currency, the answer to question 8.5 will apply.

See question 3.4 above.
4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under the PRC Instruments Law, promissory notes are deemed as on-demand payment instruments and can only be issued by commercial banks. Transfer of promissory notes will request the endorsement from an issuer or holder, as the case may be, and delivery of the same to the purchaser.

In respect of mortgage loans, according to the PRC Property Rights Law and PRC Security Law, the mortgage rights enjoyed by the seller can be transferred together with the secured indebtedness, but the mortgage rights in favour of the purchaser shall be registered with the relevant registration authority.

The sale of consumer loans will not be subject to additional or deferent sale or perfection requirements in addition to those listed in the answer to question 4.2.

The sale of marketable debt securities issued in public market, such as bonds and notes, shall be conducted through the applicable clearing agency, such as the China Securities Depository and Clearing Corporation Limited (for bonds traded on the stock exchange) and China Government Securities Depository Trust & Clearing Co. Ltd. (for notes traded on the National Inter-bank Market).

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

According to the PRC Contract Law, the assignment of contract rights by a creditor will become effective against the obligor once a notice of assignment has been served to the obligor.

Obligor’s consent for the sale of receivables is normally not required for the sale to be an effective sale against the obligor unless expressly required under the receivables contract.

If the receivables contract remains silent on the seller’s assignment of receivables to a third party, a notice instead of consent from the obligor is sufficient. However if the receivables contract expressly prohibits assignment, then a separate consent from the obligor will be required to validate the transfer.

The notice to the obligor could make the sale of receivables effective against the obligor, and will give rise to certain benefits to the purchaser, as follows:

(a) the obligor will not be able to claim for set-off rights against the seller entitled to the obligor after the service of the notice;
(b) the obligor must make payments as directed by the purchaser and the obligor can no longer discharge its obligations by making a payment to the seller;
(c) enforcement actions may be taken by the purchaser against the obligor directly without involving the seller; and
(d) depending on the content of the receivables contract and notice, the obligor and the seller may no longer amend the underlying receivables contract.

Having said that, the notice will not cut-off obligor’s existing rights against the seller under the receivables contract, such as claiming for the seller’s non-performance of its obligation.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective? Can a notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no requirements regarding the timing of service the notice to the obligor, nor are there any requirements regarding the form a notice must take or how the notice must be delivered in order for the notice to be legally valid and effective under PRC law. In practice, a notice of assignment will generally be made in written form and include a request for an acknowledgment of the assignment (or, where applicable, a consent to the assignment) by the obligor for evidence purposes, and the notice is served to the obligor on, or immediately after, the sale.

There is no time limit beyond which the delivery of notice would become ineffective. A notice may be delivered to the obligor regardless of whether an insolvency proceeding has commenced against the obligor.

A notice may relate to all or only part of the existing receivables between the obligor and the seller, and subject to the answer to question 4.10.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in the PRC? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the PRC recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions in receivables contracts prohibiting sale or assignment are generally enforceable in the PRC, and we are not aware of any exceptions to this rule.

If the seller sells the receivables to the purchaser irrespective of the prohibitions in the receivables contract, it is the seller who will be liable to the obligor for breach of contract.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Under the PRC law, a sale document must provide sufficiently specific descriptions of the receivables to be sold so that they are capable of being identified at the time of the assignment. This does
not necessarily require that each receivable has to be separately identified.

There is no legal requirement on what specific information is required, but in practice, in order to make the receivables identifiable, some basic information such as the obligor’s name, invoice date, payment date, etc., needs to be stated. The receivables being sold do not necessarily need to share objective characteristics.

A statement that the seller sells all of its receivables to the purchaser is unlikely to be deemed as sufficient identification of receivables, nor will a statement that the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors be deemed as sufficient.

**4.8 Respect for Intent of Parties; Economic Effects on Sale.**

If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

As discussed in question 4.1, the sale of receivables is to be carried out by way of assignment of contract rights. As a general contract law principle, a PRC’s court would generally respect for the parties’ intent to honour a transaction as an assignment of contract rights. However, in certain circumstances, the PRC’s court may still enquire into the economic characteristics of the transaction, for example:

(a) There is no receivables contract or the receivables contract is null and void. According to the PRC Contract Law, a contract may be deemed as null and void under the following situations:

   (i) it is concluded through the use of fraud or coercion by one party to jeopardise the interests of the state;
   
   (ii) malicious collusion is conducted to jeopardise the interests of the state, a collective or a third party;
   
   (iii) an illegitimate purpose is concealed under the guise of legitimate activities;
   
   (iv) damage to the public interest; or
   
   (v) violation of the compulsory provisions of laws and administrative regulations.

   Under such circumstances, the court may enquire into the economic characteristics of the assignment. Where the court found that the purchaser has already known the non-existence or invalidity of the receivables contract when entering into the assignment with the seller, the purchaser is likely to be deemed as granting loans to the seller.

(b) The RPA is ambiguous in respect of the assignment of receivables.

(c) The assignment of the receivables by the sellers is not a normal and fair sale with reasonable consideration and constitutes a gratuitous assignment by the sellers of its proprietary rights, or an abnormal under-sale of its assets, or an abandonment of its creditor’s rights. Under such circumstances, the assignment, sale or abandonment shall be null and void if, according to the PRC Enterprise Bankruptcy Law, such act occurs during the period commencing within one year prior to the acceptance by the people’s court of the bankruptcy case of the seller.

(d) Where the assignment of receivables is made on the condition that the seller will retain the credit risk of the receivables, such assignment is very likely to be re-characterised as a loan.

(e) Pursuant to the China Banking Regulatory Commission (“CBRC”)’s notice issued in 2009, when a banking institution assigns its credit assets, it shall not retain the credit risks of the credit assets to be assigned, nor is it allowed to retain the right of repurchase/redemption thereof. Subject to the above, to our general understanding, where the seller retains interest rate risks and/or control of collection of receivables, the assignment of receivables is unlikely to be jeopardised.

**4.9 Continuous Sales of Receivables.**

Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

PRC laws do not squarely deal with this issue. To our general experience, the following requirements need to be followed in order to make such continuous assignment of receivables enforceable (prior to the sellers’ insolvency):

(a) the RPA has clearly stated the parties’ intention of continuous assignment of receivables; and

(b) the receivables shall be identifiable. See our answer to question 4.7.

**4.10 Future Receivables.**

Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

There is no clear legal basis under the PRC’s law for the enforceability of a current transfer of future receivables before the seller’s insolvency. The general understanding is, if (a) the future receivables arise from a presently-existing receivables contract, and (b) the seller has already performed its major obligations (such as delivery of goods with agreed quantity and quality), and (c) proper notice has been served to the obligor, the present sale of receivables is unlikely to be challenged.

Where the seller goes into bankruptcy, according to the PRC Enterprise Bankruptcy Law, the administrator would have the power to reject or continue to perform any pre-petition executory contracts.

**4.11 Related Security.**

Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The nature of the assets constituting the related security will determine the additional formalities, if any, applicable to the transfer. According to the PRC Property Rights Law and PRC Security Law, the formalities applicable to the transfers of security could be categorised as follows:

(a) for those mortgages which are established upon execution of a written mortgage agreement and registration of the same of registries designated for each type of specified property, such as land use rights, urban real estate, buildings, etc., mortgage rights may be transferred together with the secured indebtedness only by re-registration of the mortgage in favour of the new mortgagee;
5 Security Issues

5.1 Back-up Security. Is it customary in the PRC to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

There is no such concept as “back-up security” under PRC law.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of PRC, and for such security interest to be perfected?

This is not applicable in the PRC.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in PRC to grant and perfect a security interest in purchased receivables governed by the laws of PRC and the related security?

According to Article 228 of PRC Property Law, the pledgor and the pledgee shall sign a written contract for the pledge of receivables.

The pledge over receivables comes into effect when the pledge has been duly registered with the Credit Reference Center (“CRC”) of PBOC.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of PRC, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in PRC or must additional steps be taken in PRC?

The security interest will not be perfected under the PRC law and registration with CRC as mentioned in question 5.3 must be taken in the PRC.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

There are no definitive rules with additional requirements applying to security interests in, or connected to, insurance policies under PRC law.

A security interest in promissory notes may be created by way of a pledge. Article 224 of the PRC Property Rights Law stipulates that the pledgor and the pledgee shall draw up a written contract for the pledge and such security interest shall be created upon the delivery of the pledged promissory note to the pledgee. In addition, pursuant to Article 98 of the Judicial Interpretations of the PRC Security Law, the promissory note shall be endorsed on the reverse side with the word “pledge” in order to be enforceable against a bona fide third party. Therefore, delivery and endorsement are the statutory requirements to create a perfect pledge on promissory notes.

A security interest in marketable debt securities, such as bonds, may be created by way of a pledge. The pledgor and the pledgee shall enter into a written contract and such security interest shall be created upon the delivery of the certificate of marketable debt securities to the pledgee if it is in the form of definitive note. Moreover, pursuant to Article 99 of the Judicial Interpretations of the PRC Security Law, the certificate shall be endorsed on the reverse side with the word “pledge” in order to be enforceable against a bona fide third party. In cases where there is no definitive certificate, the pledge rights shall be created upon the registration of such pledge at the relevant authority. The relevant depository and clearing institutions refer to China Securities Depository and Clearing Corporation Limited or Shanghai Clearing House in the case that marketable debt securities are traded on the stock exchange, or China Government Securities Depository Trust & Clearing Co. Ltd. in the case that the marketable debt securities are traded on the National Inter-Bank Market.

PRC law is silent on whether security interest could be created over the mortgage loans or consumer loans or not.

5.6 Trusts. Does PRC recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Trusts are recognised under PRC law. However, the trust in the PRC is usually in a form of special purpose trust. A CBRC-licensed trust company operates as the trustee and administers the trust assets for the benefits of beneficiaries. A PRC’s court may not give effect to collection trust in relation to receivables which is
conducted by virtue of “hold on trust” or “trust declaration”. Before the monies are turned over to the purchaser, the monetary proceeds held by the seller constitutes the seller’s asset, therefore there stands the comingling risk if the seller goes bust.

5.7 Bank Accounts. Does PRC recognise escrow accounts? Can security be taken over a bank account located in the PRC? If so, what is the typical method? Would courts in the PRC recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the PRC?

Escrow accounts are recognised and widely used in the PRC. Except that the pledge created by a bank as the pledgee over export tax rebate accounts is recognised by the PRC’s Supreme People’s Court in accordance with the Provisions of Relevant Issues Concerning the Trial of Cases Involving Loans Pledged with an Export Tax Rebate Custodian Account promulgated by the Supreme People’s Court on 22 November 2004, there is no concept of the security over a bank account under PRC law.

Bank accounts are not considered a type of property explicitly recognised by PRC law as pledgeable assets. Instead, cash is, in general, characterised as a special type of movable asset and the pledge is explicitly recognised under PRC law. The general rule under the PRC Security Law is that no pledge may be created over future funds in bank accounts. Funds in a bank account for a pledge shall be ascertained and identified at the time of perfection of the pledge. Pursuant to Article 85 of the PRC Security Law, the cash may be delivered to the creditor in its possession as security for the performance of an obligation, and the creditor may have priority in applying such cash towards the satisfaction of an obligation owed to the creditor, if the cash is “fixed” in the form of special accounts (i.e. the parties have to specify the account as well as the cash balance standing to the credit of such an account).

Any cash flow in or out after the account has been fixed will require the pledgor to re-issue a pledge notice/confimation specifying the updated cash balance. Such confirmation letter shall be issued each time a change occurs to the account balance. Otherwise, the pledge will no longer be valid under PRC law.

We noticed a few precedents that the security governed by foreign-law over a PRC account was supported by PRC court. PRC is not applicable to bank accounts other than export tax rebate custodian account. In respect of the export tax rebate custodian account, according to the Provisions of Relevant Issues Concerning the Trial of Cases Involving Loans Pledged with an Export Tax Rebate Custodian Account, the pledgee may, to the extent of the outstanding secured debt, apply all the funds in the pledged bank account to discharge such debt.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Not applicable to bank accounts other than export tax rebate custodian account. In respect of the export tax rebate custodian account, the owner of the account could not access to the funds in the export tax rebate account unless pledgee agrees to release the funds in the account in part or as a whole.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will PRC insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

After a sale of receivables that is otherwise perfected, and provided that the sale of receivables is not subject to any situations as stated in question 4.8 and the clawback discussion in question 6.3, the rights of a purchaser made in good faith will remain unaffected by subsequent insolvency proceedings of a seller. However, the situation would be different if:

(a) The purchase is deemed to only be a secured party with respect to the receivables. In such circumstances, according to the PRC Enterprises Bankruptcy Law, a moratorium would apply to all creditors (secured and unsecured) upon the filing and acceptance by the PRC court of a petition of insolvency in respect of the seller. The moratorium would last until an order of insolvency and liquidation issued by the PRC court. During the moratorium, the secured creditor would be stayed from enforcing its security. Upon liquidation of the seller’s estate, a secured creditor would have priority over all unsecured creditors over the property secured.

(b) The seller goes into insolvency after it has executed the RPA with the purchaser but neither party has completed the performance of such contracts. Under such circumstances, the bankruptcy administrator will have the right to determine whether to terminate or to continue to perform such contracts. If the bankruptcy administrator fails to notify the purchaser within two months of the acceptance of any bankruptcy petition in respect of the seller, or fails to reply within 30 days of receipt of a purchaser’s demand to make such a decision, such contracts shall be deemed to be terminated. If the bankruptcy administrator determines to continue to perform such contracts, then the purchaser shall perform such contracts, provided that the purchaser has a right to require the bankruptcy administrator to provide a guarantee for such performance. The contracts would be deemed to be terminated if the bankruptcy administrator refuses to provide a guarantee.

(c) The seller goes into insolvency after it has executed the RPA with the purchaser but the seller has not fully performed its obligations under the receivables contract. Under such circumstances, subject to the same bankruptcy administrator’s decision process as mentioned in above (b), the bankruptcy administrator will have the right to determine whether to terminate or to continue to perform such contract.
If the bankruptcy administrator determines to continue to perform such receivables contracts, then the purchaser’s rights under the RPA would not be affected.

On the contrary, if the bankruptcy administrator refuses to continue to perform such receivables contracts, the receivables contracts would be terminated accordingly. In that case, the purchaser could only be entitled to those receivables in relation to the obligations that have already been performed by the seller, whilst for the rest parts, the purchaser may only be able to claim through distribution of bankruptcy property as an ordinary creditor of the seller.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

This is not applicable in the PRC.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the PRC for (a) transactions between unrelated parties and (b) transactions between related parties?

The transactions between the seller and its related or unrelated parties will be subject to the same principle of clawback.

Article 16 of the PRC Enterprise Bankruptcy Law restricts any payments from the security provider to its creditors once the court has accepted the bankruptcy petition. The bankruptcy administrator also has the right under Article 32 of the PRC Enterprise Bankruptcy Law to request the court to revoke any preferential payments made by the bankrupted entity within the six-month period prior to the court’s acceptance of the bankruptcy petition, unless those payments benefit the bankrupted entity’s assets.

Under Article 31 of the PRC Enterprise Bankruptcy Law, the bankruptcy administrator has the right to request the court to revoke any of the following acts relating to the security provider’s assets to the extent occurring within one year prior to the court’s acceptance of the bankruptcy petition: (a) transferring the property gratis; (b) trading at an obviously unreasonable price; (c) providing property guaranty to unsecured debts; (d) paying off debts not due; or (e) abandoning claims.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

There is no concept of substantive consolidation in the PRC.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in the PRC, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) sales of receivables that only come into existence after the commencement of such proceedings?

Subject to the answer to question 4.10 regarding the recognition of future receivables, our discussion in question 6.1 (b) and (c) will apply.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the PRC establishing a legal framework for securitisation transactions? If so, what are the basics?

Since 2005, the PRC’s regulatory authorities and the market participants worked out two possible securitisation structures, i.e. special-purpose-trust structure (“SPT Structure”) and specific asset management plan structure (“SAMP Structure”).

SPT Structure – the SPT Structure is broadly used by financial institutions under the jurisdiction of the CBRC (particularly, banks and auto finance company) to package their credit portfolio into asset-backed securities traded in the National Inter-bank Bond Market (“NIBBM”). In 2005, credit portfolio asset securitisation started with the successful debut of two pilot transactions launched respectively by the China Development Bank (“CDB”) and the China Construction Bank (“CCB”). These two deals were made possible after years of joint efforts by multiple government bodies led by CBRC and the PBOC. Upon closing of the first two pilot transactions, the PBOC and CBRC jointly issued the Administrative Measures on Pilot Projects for the Securitisation of Credit Assets Procedures on 20 April 2005. In addition, the CBRC further released the Measures for the Supervision and Administration on Pilot Securitisation Projects of Credit Assets of Financial Institution to set out detailed requirements and procedures for the ABS products with SPT Structure. After a series of legal framework had been well set up, the CBRC issued another round of pilot approvals for securitisation projects across a range of underlying asset pools including residential mortgages, auto loans, SME loans and non-performing loans. By the end of 2008, eleven banks and financial institutions issued ABS in the two rounds of approvals, with a total value of RMB 67 billion. On 17 May 2012, PBOC, CBRC and the Ministry of Finance (“MOF”) released the Notice on Matters Regarding Further Expansion of Credit Asset Securitisation Pilot Projects (“Pilot Notice”), whereby the Chinese regulators announced a quota of RMB 50 billion for this new round of credit assets securitisation transactions in the PRC. According to the Pilot Notice, no re-securitisation or complex synthetic products will be encouraged by the regulatory authorities, the senior tranche of ABS have to be reviewed and rated by at least two credit rating agencies, and the originators are now required to retain a certain portion of the junior tranche (in principle, no less than 5 per cent of the total issued securities). Furthermore, the investment by one single investor should be capped within 40 per cent of the total issuance.

SAMP Structure – Running in parallel with the ABS under SPT Structure (which is designed specifically for financial institutions), the SAMP Structure was brought to the PRC market in May 2005 under an interim rule, Administrative Measures for Securitisation Business by Securities, constituted by the China Securities Regulatory Commission (“CSRC”). Furthermore, on 15 March 2013, CSRC further released the Administrative Measures on Securitisation Business of a Securities Company (“SAMP Rules”). According to the SAMP Rules, a securities firm launches a SAMP to issue certificates in the stock exchange (i.e., Shanghai Stock Exchange and Shenzhen Stock Exchange) to raise funds from investors. Upon completion of the offering, the SAMP will invest the proceeds in return for a specific, predominantly corporate asset
7.2 Securitisation Entities. Does PRC laws specifically provide for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Other than the trust scheme for SPT Structure and the specific asset management plan for SAMP Structure, PRC law is silent on the set-up of a special purpose vehicle in other forms for securitisation.

SPT Structure – the trust plan as a special purpose trust will be used as a vehicle to hold the legal title to the underlying assets, which constitute the trust assets. The SPT managed by the trustee (i.e. the CBRC-regulated trust company) is not a legal person under PRC law and the disposal and utilisation of all the trust assets will be managed in the name of the trustee. There is no corporate governance requirement in respect of the SPT. For the decision-making procedure, usually the trust document will specify the matters and circumstances subject to the approval of all or majority beneficiaries, the rest will be at the discretion of the trust company in a fiduciary capacity.

SAMP Structure – just as the SPT, the specific asset management plan is also not recognised as a legal person under PRC law. When setting up the SAMP, the investor entrusted the money into the SAMP, the securities company as manager of the SAMP will utilise the raised money to invest in the underlying asset. In comparison with the SPT, SAMP is less advanced in terms of legal integrity, tax neutrality and accounting clarity, a situation which in turn might affect its ability to achieve true sale and bankruptcy remoteness.

7.3 Non-Recourse Clause. Will a court in PRC give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

A non-recourse clause is an enforceable contractual arrangement under PRC law.

7.4 Non-Petition Clause. Will a court in the PRC give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

PRC law does not expressly prohibit or restrict a non-petition clause, and we believe it will impose enforceable obligations on a party who makes a non-petition undertaking. However, there is the theoretical argument that whether the rights of claim conferred upon by the PRC laws and regulations may not be waived by the provisions contained in the agreement, and to our knowledge, such non-petition clause has not been tested in a PRC court.

7.5 Priority of Payments “Waterfall”. Will a court in the PRC give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

A PRC court will generally give effect to a contractual provision on payment distribution based on the principle of freedom of contract.

7.6 Independent Director. Will a court in the PRC give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

A PRC court generally may give effect to a contractual provision or a provision in a party’s organisational documents prohibiting the directors from taking specified actions without the affirmative vote of an independent director. However, in the PRC, the shareholder can convene a shareholding meeting to decide the filing of bankruptcy of the company without any proposal from board level. As such, the independent director’s vote cannot block the resolution of shareholders in respect of a bankruptcy filing.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the PRC, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the PRC? Does the answer to the preceding question change if the purchaser does business with other sellers in the PRC?

Merely owning receivables and collecting and enforcing receivables will not result an offshore purchaser being subject to a financial licence requirement.

Notwithstanding the above, if the purchaser is to establish a business existence in the PRC for a receivables purchase business, according to the relevant regulations issued by the Ministry of Commerce in 2012, it may be deemed as engaging in commercial factoring business, which will in turn give rise to approval from the Ministry of Commerce. For your information, the foreign investment in commercial factoring is currently still under trial, and the foreign invested commercial factoring companies are only allowed to be established in Shanghai and Tianjin.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The seller may, without any licence, continue to enforce and collect receivables after the completion of the sale to the purchaser. A third party replacement servicer may or may not require any licence to enforce and collect sold receivables depending on the nature of the underlying assets, e.g. in a loan, the servicer is required to obtain a licence from the CBRC, in financial leasing, the servicer shall obtain relevant licence as a financial leasing company.
8.3 Data Protection. Does the PRC have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The PRC Contract Law requires parties to a contract to act in good faith and perform obligations such as maintaining confidentiality in accordance with the nature and purpose of the contract and/or trade usage. Parties to the contracts must comply with this general principle of confidentiality.

The Interim Provisions on the Protection of Trade Secrets of Central Enterprises, promulgated by the State-Owned Assets Supervision and Administration Commission on 25 March 2010 classifies customer information as one of the trade secrets owned by the central state-owned enterprises. It also requires such enterprises to enter into a confidentiality agreement with the counterparty when dealing with customer information and other trade secrets.

Where the seller is a financial institution licensed by CBRC, the seller will be subject to general confidentiality requirements applicable to financial institutions. In particular, according to a notice issued by the PBOC in 2011 (YIN FA 2011 No. 17), banking institutions in the PRC are not allowed to provide any information regarding individual consumers to any offshore entities or individuals.

See our discussion in question 1.2.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the PRC? Briefly, what is required?

Yes, PRC imposes strict controls on both convertibility and transferability of the RMB, which is mainly governed by PRC Foreign Exchange Regulations and various rules and notices issued by the State Administration of Foreign Exchange (“SAFE”).

A new tendency regarding payment of RMB outside the PRC is, starting from year 2009, PBOC launched a RMB internationalisation scheme, under which PRC entities are allowed to make payment of RMB to persons outside PRC for international trade settlement.

8.5 Currency Restrictions. Does the PRC have laws restricting the exchange of PRC’s currency for other currencies or the making of payments in the PRC’s currency to persons outside the country?

The sales of taxable goods and the provision of labour services in relation to the processing of goods and of repair and replacement services within the PRC are subject to Value Added Tax (“VAT”). VAT rate ranges from 0 per cent to 17 per cent. The standard rate is 17 per cent.

Business Tax (“BT”) applies to the provision of services (excluding processing services and the repair and replacement services). It also applies to the transfer of intangible assets such as goodwill, patents and the sale of real estate properties in the PRC. BT rates range from 3 per cent to 20 per cent. BT and VAT are mutually exclusive.

The service fee received by the collection agent shall generally be subject to BT. Normally, the sales of receivables are not taxable with regards to both VAT and BT. However, the MOF and State Administration of Taxation jointly issued two circulars in 2011, officially kicking off the transformation of BT to VAT (“Transformation”) for the service industry. According to the two circulars, depending on the nature of the receivables, certain categories of service previously imposed by BT may now be subject to VAT (e.g. financial leasing sector). Thus the sales of receivables in relation to such services technically may also be subject to VAT.

The transformation is still in a state of flux, the practice of turnover tax implications of the sales of receivables may vary in different locations.

The obligors are obliged to withhold and settle the withholding tax with the PRC tax authority for the seller or purchaser.

Provided that the seller or the purchaser is domestically incorporated, there would be no PRC withholding taxes imposed on the payment on receivables made by a PRC obligor to the seller or purchaser.

9.2 Seller Tax Accounting. Does the PRC require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

There is no express accounting policy in the PRC adopted by the seller and purchaser for tax purposes in the context of a securitisation. The seller shall comply with the China Accounting Standard for Enterprise No. 23 – Derecognition of Financial Assets (“CAS No.23”). CAS No. 23 was published by the MOF in 2006 and replaced the former circular Accounting Provisions of Credit Assets Securitisation.

According to the circular of Relevant Taxation Policy Issues Relevant to the Securitisation of Credit Assets (Caishui [2006] No. 5), the originator shall realise its gains and losses derived from the sales of credit assets in a securitisation of credit assets in accordance with PRC Corporate Income Tax Law and settle the Corporate Income Tax (“CIT”) accordingly.

9.3 Stamp Duty, etc. Does PRC impose stamp duty or other documentary taxes on sales of receivables?

The agreement for sales of receivables does not fall into the categories of taxable documents, and thus will not be subject to any stamp duty.

9.4 Value Added Taxes. Does PRC impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Yes, PRC imposes strict controls on both convertibility and transferability of the RMB, which is mainly governed by PRC Foreign Exchange Regulations and various rules and notices issued by the State Administration of Foreign Exchange (“SAFE”).

A new tendency regarding payment of RMB outside the PRC is, starting from year 2009, PBOC launched a RMB internationalisation scheme, under which PRC entities are allowed to make payment of RMB to persons outside PRC for international trade settlement.

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in PRC? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

PRC withholding taxes may be imposed depending on the nature of the receivables and the location of the seller and purchaser.

Interests and royalties (including also royalties for use of the industrial and commercial equipment) sourced from the PRC and derived by a seller or purchaser being a non-tax resident will be subject to a withholding tax at the rate of 10 per cent. The tax rate may be reduced or exempted by the applicable double tax treaty.
9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

If the tax authority deems the sale of receivables to be taxable from the VAT perspective under the new VAT scheme after the Transformation, the seller would be the taxpayer and shall undertake the obligations of filing and settling the VAT. It is not likely that the tax authority would be able to claim unpaid taxes against the purchaser or against the sold receivables, unless the receivables are considered by the tax authority to have been sold with no consideration or with an unreasonable price, under which the tax authority is entitled to petition a court to revoke such sale of receivables.

9.6 Doing Business. Assuming that the purchaser conducts no other business in PRC, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in PRC?

According to PRC Corporate Income Tax Law, if the purchaser is not a PRC resident for tax purposes, it is taxed only on its PRC and foreign sourced income that is attributable to their establishments or places of business in the PRC, which shall be assessed depending on various factors (including the nature of receivables, the activities undertaken by the purchaser in the PRC, etc.). If there is a double tax treaty between PRC and the country (or region) where the purchaser is located, the provisions of such treaty shall prevail. Assuming the purchaser is located outside the PRC, generally the purchaser will not be liable to tax in the PRC from the CIT perspective provided that its activities are limited only to purchasing receivables, appointing the seller as its servicer and collection agent, or enforcing against the obligors and it conducts no other business in the PRC, unless such activities undertaken by the purchaser constitute a permanent establishment as prescribed by the applicable double tax treaty. Please refer to questions 9.3 and 9.4 above for the implications of turnover taxes and stamp duty.
Roy Zhang is a Partner based in Shanghai and Hong Kong and specialises in debt capital markets, structured finance and private finance. 
Roy concentrates his practice principally in the areas of both debt and equity financing transactions with an emphasis on leveraged financing, structured financing and technology focused industries. He represents commercial and investment banks, private equity, venture capital investors, industrial sponsors, and private and public companies, in all aspects of complex business transactions, including leveraged buy-outs and financings, strategic mergers, acquisitions and joint ventures, minority equity investments, and debt and equity restructuring. Roy has led transactions in a wide variety of industries including financial services, energy, biotechnology, healthcare, mining and mineral, logistics and transportation, and infrastructure.

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With depth in all aspects of structured finance, we have unparalleled experience in securitisation deals both in China and globally. From the beginning of PRC securitisation in 2005, we have worked on a large number of deals, including some pilot cases in Chinese securitisation history, including the pilot RMBS deal, pilot receivables ABS deal, and pilot auto loan ABS deal. Today, King & Wood Mallesons is recognised as one of the leading Chinese law firms in the area of securitisation transactions, providing a full range of services to our clients.
**Chapter 13**

**Czech Republic**

**TGC Corporate Lawyers**

1 **Receivables Contracts**

1.1 **Formalities.** In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

In the Czech Republic, the sale of goods or services is usually achieved by means of a contract which can be created upon the sale or upon the delivery of goods or services. According to both the Czech Civil and Commercial Codes, sale contracts do not necessarily have to be made in writing. As a consequence, no specific form of the receivables contract is required in order to prove the sale of goods or services; invoices or other relevant documents suffice. Moreover, receivable contracts may be made in an implied fashion, e.g. as a result of the behaviour of the parties. It is, however, recommended to make a written contract in order to prove the existence of such receivables, with the aim of facilitating potential litigation if any form of disagreement were to arise.

1.2 **Consumer Protections.** Do the Czech Republic laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

No statutory limit rates exist in regard to a capped interest rate on consumer credit. However, there is a number of mandatory regulations applicable, the most important being that the loan can be granted only in such an amount which, according to the consumer’s financial situation and applying professional care of purchaser when considering the consumer financial situation, can be paid up. Interest must be calculated in a fashion which is in accordance with both the law and with the contract dictating the credit terms between both parties. Written form of the contract is obligatory, otherwise it is deemed invalid.

The law provides a statutory right to charge for late payment provided that a binding contract was not agreed upon between the parties. In this case, the annual amount of late payment interest is equal to the repo rate set by the Czech National Bank increased by seven percentage points (on 27 March 2013 the applicable late payment interest rate was 7.05 per cent per annum).

Consumers have the right to withdraw from the contract for no reason and without any risk of sanction in a period of 14 days after the conclusion of the contract. Czech law is, since 25 February 2013, fully compliable with the EU regulations 2008/48/ES dated 23 April 2008 on consumer credit loan and 2011/90/EU.

1.3 **Government Receivables.** Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

There are no special rules applicable to government receivables contracts. Government agencies and the Czech state in general are considered a standard legal entity.

2 **Choice of Law – Receivables Contracts**

2.1 **No Law Specified.** If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the Czech Republic that will determine the governing law of the contract?

The seller and the obligor are to determine which law governs their mutual relations if there is an international dimension to their relationship. The choice of law may also be implied.

In the event that no governing law is specified, and that the relationship has an international dimension, the mutual relations of the contracting parties are governed by the law which would constitute a reasonable foundation for the relationship. Generally, sale and purchase agreements are usually subject to the laws of the state where the sale originated, whether or not the contract was created upon sale or delivery.

2.2 **Base Case.** If the seller and the obligor are both resident in the Czech Republic, and the transactions giving rise to the receivables and the payment of the receivables take place in the Czech Republic, and the seller and the obligor choose the law of the Czech Republic to govern the receivables contract, is there any reason why a court in the Czech Republic would not give effect to their choice of law?

Under Czech law, an international dimension must be present in the legal relationship in order for the parties to have the right to choose a foreign governing law. Otherwise, Czech law is always applicable. As no international element is included in the above
described case, Czech law will apply and the choice of law will be considered void due to its irrelevance.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor

If the seller is resident in the Czech Republic but the obligor is not, or if the obligor is resident in the Czech Republic but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the Czech Republic give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

As set out in question 2.1 above, the contracting parties are entitled to determine the law governing their mutual relations, provided that an international element exists. The choice of a third law may also be chosen provided that it is not chosen solely for the purpose of avoiding Czech law. The parties cannot evade the application of mandatory Czech law; Czech Republic’s public policy must be protected. Therefore, if a relevant area of the chosen law is contrary to Czech’s public policy, its use will be limited and deemed illegal.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in the Czech Republic?

Yes, the Convention was ratified by the Czech Parliament and has been in effect since 1 April 1991.

### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does the Czech Republic’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e. the Czech Republic’s laws or foreign laws)?

Czech law generally does not require the sale of receivables to be governed by the same law as the one governing the receivables themselves provided that there is an international element included in the receivables purchase contract. Such a choice of law will then be allowed.

#### 3.2 Example 1: If (a) the seller and the obligor are located in the Czech Republic, (b) the receivable is governed by the law of the Czech Republic, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the Czech Republic to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the Czech Republic, will a court in the Czech Republic recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

In this case, the relationship between the seller and the obligor is governed by Czech law and therefore requirements of Czech law must be met. The sale of receivables must be notified to the obligor; otherwise, the obligor would be entitled to pay the receivables to the seller. In addition to this, limitations as described in question 2.3 above must be taken into account.

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside the Czech Republic, will a court in the Czech Republic recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Czech courts will apply the specific foreign law by which a purchase agreement is governed. Therefore, only the requirements of the foreign governing law must be met to recognise that sale as being effective against the seller and other third parties.

#### 3.4 Example 3: If (a) the seller is located in the Czech Republic but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in the Czech Republic recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the Czech Republic own sale requirements?

Czech courts will apply the rules of the chosen law (even if they do not comply with the Czech regulation), provided that the choice of law is valid and justified. However, limitations as set out above (public policy of the Czech Republic) must be taken into account.

#### 3.5 Example 4: If (a) the obligor is located in the Czech Republic but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in the Czech Republic recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the Czech Republic own sale requirements?

Czech courts will apply the rules of the chosen law (even if they do not comply with the Czech regulation), provided that the choice of law is valid and justified. However, limitations as set out above (public policy of the Czech Republic) must be taken into account.
3.6 Example 5: If (a) the seller is located in the Czech Republic (irrespective of the obligor’s location), (b) the receivable is governed by the law of the Czech Republic, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in the Czech Republic recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the Czech Republic and any third party creditor or insolvency administrator of any such obligor)?

Czech courts will apply the rules of the chosen law, provided that the choice of law is valid and justified. However, as referred to above, the obligor must be notified of the sale since the receivable itself is governed by the Czech law. As set out above, other limitations must be taken into account.

4 Asset Sales

4.1 Sale Methods Generally. In the Czech Republic what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Czech law uses the term “assignment of receivables”. As a result, the seller (original creditor) is called the assignor, and the purchaser (new creditor) is called the assignee. An assignment of receivables is not a sale per se, but merely a change in obligations (change of creditor).

An assignment of receivables (i.e. sale of receivables) is performed by written agreement between the seller and the purchaser. While the consent of the obligor is not required, he has to be notified without unnecessary delay in accordance with the principles of “fairness of assignment”.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

For an assignment of receivables, no additional formalities other than those mentioned above are required.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

An assignment of promissory notes (order papers) is executed by means of endorsement. Other promissory notes are considered to be simple receivables and can be assigned by a written contract as described in question 4.1 above.

Under Czech law, mortgage loans are accessory rights and therefore follow the destination of the secured receivable. However, notification of the assignment to the security provider is required.

With regard to consumer loans, no additional formalities are required.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment, or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Generally, a notification of the sale to the obligor is required to be effective against the obligor. Consent of the obligor is not required. However, if according to an agreement between the seller and the obligor assignment of the receivables is forbidden, then the seller is not allowed to assign the receivables. Lack of receivables sale prohibition allows the seller to assign the receivables (explicit permission is not required).

In each case, the sale must be notified to the obligor without unnecessary delay either by the seller or purchaser. The obligor may fulfill his obligation directly towards the seller until the obligor is notified of the assignment or until the purchaser proves the assignment to the obligor.

Regarding the rights of the obligor, any receivables due to the seller, which exist at the moment of notification, may be claimed for the benefit of the purchaser, provided that they were notified to the obligor without unnecessary delay. This also applies for receivables which were not payable at the moment of notification. Moreover, if the seller enforces a sold receivable on his own behalf (but for the benefit of the purchaser), and the obligor wants to use set-off rights, only receivables due from the seller to the obligor may be used (not those due from the purchaser).

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There is no specific form of the notice to the obligor defined under Czech law. However, written notification is strongly recommended and very standard.

As previously mentioned, the notice must be delivered to the obligor without unnecessary delay after the sale of the receivable. The receivable must also be clearly defined in the notification (see questions 4.7, 4.9 and 4.10 below) to prevent any mistake of the assigned receivable.

In case of marketable debt securities, the following rules apply:
- for book-entered debt securities, registration with the Central Depositary is required; and
- debt securities in documentary form are assigned by means of endorsement if they are debt securities to order or by means of handover in case of bearer debt securities.
4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in the Czech Republic? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the Czech Republic recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

The following types of receivables may not be assigned/sold:

- receivables which cease at the moment of death of the obligor;
- receivables whose content would be changed by the change of creditor (protection of obligor); and
- receivables which cannot be affected by court execution, i.e. which are legally unenforceable (protection of purchaser) such as social allowances defined by a special law;
- entitlement to pension allowance (§ 844 of the Civil Code); and
- pre-emption right (§ 604 of the Civil Code).

In addition to this, receivables may not be sold/assigned if an agreement between the obligor and the seller forbids so. In case of breach of this, a receivables sales contract is considered absolutely (ex tunc) void according to § 39 of the Czech Civil Code.

A contract attempting to assign any of the above listed receivables would be void. In such circumstances, the obligor’s situation remains unchanged and he is liable towards the seller (the debt is not considered fulfilled in case the obligor performs towards the purchaser). However, damages in liability may arise between relevant parties.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

There is a legal requirement that the assigned receivable must be identifiable; generally, a receivable can be identified with precise reference to the legal facts on which it is based, e.g. the amount, maturity, and possibly on other facts. However, exact requirements of “sufficient determination” are not expressly specified in Czech law.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Czech courts will not enquire into the economic characteristics of the transaction. Provided that all of the formal requirements of the sale are met, the contract will be considered valid.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The continuous sale of receivables can be contentious under Czech law, particularly if executed using a framework contract between the seller and the purchaser. However, future receivables must be identifiable.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Sale of future receivables is not expressly forbidden under Czech law. However, future receivables must still fulfill the legal requirement that a sold receivable must be identifiable. Generally, future receivables that arise in accordance with one specific contract where the amounts are known or calculable at the moment of assignment, may be assigned through one single contract. However, receivables which arise under a framework agreement (e.g. a purchase framework contract) are not sufficiently determined and therefore such an assignment contract would be probably considered void. In such circumstances, it is usual to assign the receivables periodically as they arise.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Security under Czech law follows the destination of the secured receivable. As a result, security is transferred concurrently with the sale of receivable. However, notification of the assignment to the security provider is obligatory.

5 Security Issues

5.1 Back-up Security. Is it customary in the Czech Republic to take a “back-up” security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

In our experience, it is unusual to take back-up security over the seller’s ownership interests.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the Czech Republic, and for such security interest to be perfected?

Under Czech law, a security interest is usually determined by a written contract (“závazní smlouva”) which must clearly specify the security as well as the secured claim. Depending on the nature of the security, different requirements must be met in order to perfect the security interest. In the case of receivables, the security interest is perfected at the moment of conclusion of the contract.
5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the Czech Republic to grant and perfect a security interest in purchased receivables governed by the laws of the Czech Republic and the related security?

As set out in question 5.2, a security interest may be granted by a written contract between a purchaser and a funding provider (i.e. security taker). However, the secured claim must belong to the security taker at the moment of creation of such security interest. Should the security interest be created in the purchaser’s entire asset, the contract must take the form of a notary deed. Moreover, registration of the security interest in the Register of Securities is necessary in order to perfect such security interest.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the Czech Republic, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in the Czech Republic or must additional steps be taken in the Czech Republic?

Generally, such a security interest would be treated as valid and perfected, unless it is contrary to the protection of public policy or contrary to mandatory provisions of Czech law. If the receivable is governed by Czech law, rules under Czech law protecting the rights of the original obligor shall apply (notification of the original obligor).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

The following additional requirements must be met in order to grant such security interests:

- in the case of promissory notes, a security endorsement is required;
- in the case of mortgage loans and consumer loans, no special requirements are required; however, registration in the Register of Securities is possible if mentioned in the corresponding contract;
- in the case of marketable debt securities;
- book-entered debt securities: registration with the Central Depository is required; and
- debt securities in documentary form: a security endorsement is required for debt securities to order, and handover to the security taker is required for bearer debt securities.

5.6 Trusts. Does the Czech Republic recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

As of March 2012, Czech law does not recognise trusts. However, the new Civil Code (planned to take effect as of 1 January 2014) contains material relevant to the regulation of trusts ("správa cizího majetku").

5.7 Bank Accounts. Does the Czech Republic recognise escrow accounts? Can security be taken over a bank account located in the Czech Republic? If so, what is the typical method? Would courts in the Czech Republic recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the Czech Republic?

Escrow accounts are recognised in the Czech Republic and most Czech banks offer such accounts to clients. They are especially used for payment of the purchase price for sales and for real estate transactions. It is not forbidden to use such accounts for other types of payment. There are two possible ways to take security over a Czech bank account:

- Security interest over funds in a bank account is a specific type of security interest in receivables. Creation of such a security interest must be notified to the relevant bank.
- Financial security is, in principle, a security interest in financial collateral in favour of the security taker or a transfer of financial collateral to the security taker. A contract for financial security is not required to be in writing. However, financial security is created on the basis of registration of such security interest in the corresponding register of investment facilities or handover of financial collateral to the security taker.

As previously mentioned, security over a bank account governed by foreign law should be recognised in the Czech Republic. However, rights of the obligor must be preserved. Therefore, the obligor must be notified.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Security over a bank account is a specific type of security interest in receivables. To be effective, the establishment of such a right must be notified to the bank in which the relevant bank account is held. As a result of this, a bank is in the position of a sub-debtor towards the secured party. Therefore, the bank – not the secured party – has control over funds in the account.

After commencement of enforcement of security, the debtor loses the right to withdraw funds from the account or to use these funds for payments or for other dispositions up to the amount of secured receivable and its accessories. This prohibition shall not apply to funds up to the amount equal to the so-called living minimum, i.e. to CZK 6,820 in the year 2013. Furthermore, this prohibition shall not apply in the case of funds which intended to be paid to employees of the debtor in the form of salaries or other remunerations replacing the salaries.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The owner of the bank account which is the object of a security have unlimited access to the funds in the account prior to enforcement. A problem seems to be that the balance in the account is usually not constant over time and in practice, it varies considerably. It is true that in the case of debit (negative) balance in the account, there is
actually no value which may be realised by means of security enforcement and no receivable actually exists. However, this situation (whether temporary or long-term) does not change the fact that there is still the original contractual relationship between the bank and the bank account holder as well as there still being a receivable of the bank account holder against the bank. As a result of this, even if the balance of the bank account is negative, the security still remains and is enforceable in the future.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the Czech Republic insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the purchaser is the owner of purchased receivables, there is no automatic stay of action and the purchaser is able to collect, transfer, enforce or exercise any other rights over the receivables. As set out in question 6.2 below, insolvency proceedings may include any asset in the insolvency estate, while subsequent actions in relation to the exclusion of assets not owned by the insolvent seller are also possible. However, litigation of such actions may take up to several years.

If the purchaser is not the owner of the receivables, but only a secured party, the purchaser will be treated as a security taker in the insolvency proceedings, i.e. the purchaser will be a secured creditor. During the insolvency procedure, secured creditors are paid through monetisation of the asset against which their receivable has been secured.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

An insolvency official, known as a bankruptcy trustee, lists assets to be added to the bankruptcy estate. After such listing no person is entitled to deal with the listed assets. However, it is possible to exclude an asset from such list through legal action.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the Czech Republic for (a) transactions between unrelated parties and (b) transactions between related parties?

The insolvency official can rescind or reverse transactions that took place during a “suspect” or “preference” period if such acts reduce the potential for satisfaction of creditors (e.g. supplies or other legal acts without adequate consideration) or if such transactions favoured some creditors over others. The bankruptcy court can declare such acts/transactions ineffective on the basis of an action by the insolvency official (a set aside action – “odpáreví žaloba”).

For related persons, a set aside action can be filed in relation to acts carried out in the three years before the start of the insolvency procedure. Transactions between unrelated persons may be set aside if they were made in the one-year period before the start of the insolvency procedure.

For acts intended to reduce the satisfaction of creditors, the suspect period lasts five years.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

This is not possible under Czech law.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in the Czech Republic, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

On a strict reading of the Czech Insolvency Act, an insolvent person is obliged to refrain from dealing with any asset included in the insolvency estate, as well as assets that may belong to it, provided that it may cause a substantial change in the composition, use or destination of the asset or may cause significant reduction of the asset. Legal acts by a debtor made under these restrictions will be ineffective against creditors. However, the restriction does not apply to operations required to operate in the normal course of business.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the Czech Republic establishing a legal framework for securitisation transactions? If so, what are the basics?

Under the law there are no specific securitisation laws nor special provisions in other laws.

7.2 Securitisation Entities. Does the Czech Republic have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The Czech Republic has no special legislation regarding the establishment and operation of special purpose entities for securitisation.

7.3 Non-Recourse Clause. Will a court in the Czech Republic give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

For the mere assignment of a receivable, the seller is only liable for the enforcement of the receivable by the purchaser if he received consideration for the assignment and the liability was agreed.
Otherwise, the purchaser is not entitled to claim payment from the seller.

**7.4 Non-Petition Clause.** Will a court in the Czech Republic give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Under Czech law, any agreement relating to the waiving of future rights is invalid. This applies not only to consumer relationships but also in commercial relations among equally strong parties. Non-petition or similar clauses are therefore often difficult to rely on.

However, if such a clause is concluded in a contract governed by a foreign law, a Czech court may not necessarily view this as against public policy, especially if agreed between equally strong parties. Therefore, in such circumstances, a non-petition clause might be effective.

**7.5 Priority of Payments "Waterfall".** Will a court in the Czech Republic give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

If such a clause is concluded in a contract governed by a foreign law, a Czech court may not necessarily view this as against public policy, especially if agreed between equally strong parties. Therefore such clause might be effective.

**7.6 Independent Director.** Will a court in the Czech Republic give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The same approach as described in question 7.4 above applies. Moreover, under the Czech Commercial Code, directors have a duty of care towards a company. Such a provision may therefore be unenforceable if it is viewed as limiting such duty of care.

**8 Regulatory Issues**

**8.1 Required Authorisations, etc.** Assuming that the purchaser does no other business in the Czech Republic, will its purchase and ownership or its collection and enforcement of receivables result in its being required to comply with any consumer protection law or its being subject to regulation as a financial institution in the Czech Republic? Does the answer to the preceding question change if the purchaser does no other business in the Czech Republic, in the seller’s name and on the seller’s account?

The purchase and ownership of receivables does not require a business trading licence in the Czech Republic. On the other hand, the collection and enforcement of purchased receivables may require a business trading licence in the Czech Republic if it is a continuous activity carried out independently and in a company’s own name (with responsibility) in order to gain profit.

The purchase and ownership of receivables, as well as the collection and enforcement of purchased receivables, do not require a financial institution licence.

**8.2 Servicing.** Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Czech law allows a seller to enforce a sold receivable at the request of the purchaser, in the seller’s name and on the purchaser’s account. On this basis the seller does not need any special licence in order to continue to enforce and collect receivables. Moreover, the seller is able to appear before a court without having any specific permission to do so.

The collection and enforcement of purchased receivables by a third party replacement servicer is likely to be considered as a service provided by the servicer, particularly if carried out continuously, independently, and in the name of the servicer (with responsibility) in order to gain profit. A business trading licence is therefore likely to be required.

**8.3 Data Protection.** Does the Czech Republic have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Czech data protection law relates only to individuals’ personal data. In such circumstances, a special notification to the Personal Data Protection Office is required. Certain duties must also be fulfilled in accordance with the Czech Act on Personal Data Protection.

If the obligor is a legal entity, such data protection restrictions will not apply. We also note that “Bank secrecy” restricts banks from providing information about their customers without such customers’ consent, irrespective of whether the obligors are individuals or legal entities. However, this can prohibit banks from carrying out activities which are in their legitimate interest. Banks may therefore in certain circumstances provide information on their customers in order to conclude a valid contract for assignment of receivables.

**8.4 Consumer Protection.** If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the Czech Republic? Briefly, what is required?

Consumer protection applies specifically to the purchase of consumer credit loans. Pursuant to the Czech Act on Consumer Credit Loans (implementing the corresponding EU directive), the consumer benefits from the following rights:

- right to pay the receivable back before the due date without sanctions, where the costs related to the credit loan must be equitably reduced; and
- right to terminate a contract for a credit loan within 14 days of conclusion of such contract without providing a reason.

In addition, the consumer is also entitled to use a number of defences, including set-off, which are available to the consumer against the seller prior to notification of the sale.
8.5 Currency Restrictions. Does the Czech Republic have laws restricting the exchange of the Czech Republic currency for other currencies or the making of payments in the Czech Republic currency to persons outside the country?

The Czech Republic does not restrict the exchange of Czech Crowns for foreign currency. Similarly, payments to entities outside the Czech Republic are not restricted. However, some large-scale payments must be notified with a view to preventing money laundering.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the Czech Republic? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payment by an obligor to the seller or to the purchaser will not be subject to a withholding tax in the Czech Republic. However, if the recipient of the payment resides outside the Czech Republic (i.e. is a Czech tax non-resident), a payment of receivables acquired by way of assignment is considered to be income sourcing from the Czech Republic. Such income will therefore be subject to Czech income tax and the recipient of the payment will be obliged to submit a Czech income tax return and pay tax according to Czech tax rules and regulations.

In addition, if the recipient of the payment is not a tax resident of one of the EEA Member States and there is no double taxation treaty concluded between its resident state and the Czech Republic, a deposit for tax liabilities equal to 1 per cent of the amount of the payment must be deducted from the payment.

9.2 Seller Tax Accounting. Does the Czech Republic require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No special accounting rules are applicable in the context of a securitisation.

9.3 Stamp Duty, etc. Does the Czech Republic impose stamp duty or other documentary taxes on sales of receivables?

Czech tax law does not impose any stamp duty or any other documentary tax upon the sale of receivables.

9.4 Value Added Taxes. Does the Czech Republic impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Sales of goods or services are subject to VAT in the Czech Republic, provided that the origin of a taxable supply is located in the Czech Republic. However, some specific supplies are VAT exempt, e.g. supply of goods to another EU Member State, financial services, insurance services, sale and rent of plots, buildings, apartments and commercial premises, etc.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

If the purchaser is a taxable resident of the Czech Republic, the tax authority may be able to claim for unpaid taxes against the purchaser. However, this is only possible if the purchaser had, should have, or could have known that taxes were not going to be paid at the moment of realisation of the sale. In addition, the purchaser is liable for unpaid tax if the actual price of the taxable supply is either without economic justification, obviously different from the usual market price, or if the payment was paid to a bank account held at a bank outside the Czech Republic or to a bank account held at a Czech bank which was not published on the websites of the Czech Tax administration (“Česká daňová správa”).

9.6 Doing Business. Assuming that the purchaser conducts no other business in the Czech Republic, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the Czech Republic?

As set out in question 9.1 above, if a purchaser is not a Czech tax resident, payment of receivables acquired by means of assignment will be considered income sourced in the Czech Republic. The purchaser will therefore be obliged to submit an income tax return in the Czech Republic and declare this income. Such income will be subject to Czech income tax (depending on the nature of the purchaser, the standard corporate income tax rate of 19 per cent or the personal income tax rate of 15 per cent will be applicable).
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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) No formal requirements are necessary to create an enforceable debt obligation (save for a written requirement in terms of consumer credit agreements, cheques or other special areas of law). An oral or written receivables contract will suffice; however, an oral contract will be difficult to prove. In case of enforcing a debt obligation directly through the bailiff’s court, without obtaining a judgment, the debt obligation must be an instrument of debt including a clause of enforcement. It is not market practice for the buyer to issue an instrument of debt.

(b) An invoice will be sufficient to create an enforceable debt obligation (for the avoidance of doubt, an invoice is not directly enforceable through the bailiff’s court). Formal receivables contracts are not used in Denmark. However, in case the obligor objects to the invoice, it may raise doubts as to the existence of a contract between the parties.

(c) The behaviour between the parties may create a “contract” based on the principle of passivity, practice or customary procedures applicable in such areas of contract law. Furthermore, a historic relationship may create a contract to the extent that there is some form of recording of the debt and the circumstances which gave rise to the debt, and this can be substantiated, if contested by the obligor.

1.2 Consumer Protections. Do Danish laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) Apart from provisions on usury in the Danish penal code, there are no laws which limit the interest rate that can be charged.

(b) The Danish Interest Rate Act provides creditors with a statutory right to demand default interest on any late payments. The default interest rate is the aggregate of: (i) the lending rate of the Danish National Bank (fixed every half year); and (ii) a margin of 7.00 per cent per annum. In case the credit interest rate exceeds the statutory default interest rate, the creditors are entitled to apply the credit interest rate as the default interest rate.

(c) The Danish Consumer Credit Act entitles the consumers to discharge payment obligations pursuant to any credit agreements entered into prematurely, either in full or partially. In addition, any credit agreements not limited in time may be cancelled by the consumers from time-to-time or with one month’s prior notice.

(d) The Danish Consumer Credit Act grants the consumers a right to a reduction of costs and expenses in case of premature discharge. In addition, although not specifically aimed at consumers, the Danish Instrument of Debt Act contains provisions which, to some extent, entitle an obligor to exercise rights of set-off even after the receivable has been transferred.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

As stated in the answer to question 1.1(b), receivables contracts are not as such used in Denmark. However, any receivable which evidences a debt of the government or a government agency can, in general, be sold to any third party in the same manner as other receivables.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Denmark that will determine the governing law of the contract?

As the receivable would normally only be evidenced by an invoice, the governing law of the invoice would be identical with the governing law of the contract which gave rise to the invoice. The governing law of the contract giving rise to the invoice will be subject to the EC Convention on Law Applicable to Contractual Obligations (Rome 1980), which has been ratified by, and is in force in, Denmark. Pursuant hereto, the applicable law, in the absence of choice, shall be the law of the country with which it is most closely connected, however, subject to the qualification that the law does not contravene with: (i) Danish public policy (ordre public); (ii) international mandatory rules to which the contract has a close connection or the international mandatory rules of Denmark irrespective of the law otherwise applicable to the contract; and (iii) mandatory consumer rules of the country in which the consumer resides.
The EC Regulation on the Law Applicable to Contractual Obligations (Rome I) does not apply to Denmark; cf. the Protocol on the position of Denmark in the EU.

### 2.2 Base Case. If the seller and the obligor are both resident in Denmark, and the transactions giving rise to the receivables and the payment of the receivables take place in Denmark, and the seller and the obligor choose the law of Denmark to govern the receivables contract, is there any reason why a court in Denmark would not give effect to their choice of law?

No, a choice of Danish law is valid and will be upheld by the Danish courts in accordance with the EC Convention on Law Applicable to Contractual Obligations (Rome 1980).

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Denmark but the obligor is not, or if the obligor is resident in Denmark but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Denmark give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Yes, generally the seller and the obligor may, by way of inclusion of a choice of law clause in the contract, stipulate that foreign law shall govern their contractual relationship, and such choice of law is valid and will be upheld by the Danish courts, subject to the qualification that the foreign law does not contravene with: (i) Danish public policy (ordre public); (ii) international mandatory rules to which the contract has a close connection or the international mandatory rules of Denmark irrespective of the law otherwise applicable to the contract; (iii) mandatory consumer rules of the country in which the consumer resides; and (iv) the mandatory laws of any country with which the contract has a significant connection.

Danish public policy is deemed to have little practical meaning as the case law relates to matters which are manifestly incompatible with the public policy of Denmark and is to be applied as a precautionary measure in order to prevent an apparent preposterous result.

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Denmark?

CISG is fully effective in Denmark as of 1 February 2013. The former reservation made in respect of Part II regarding the formation of contracts has now been repealed.

### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does Danish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Danish laws or foreign laws)?

No, the parties are free to choose a different law than the law governing the receivables themselves. Unless there are any substantial arguments in favour of the opposite, we recommend that the parties choose the law that governs the receivables as the governing law of the receivables purchase agreement. In general, there are no obvious benefits from choosing a different law to govern the receivables purchase agreement than the one governing the receivables.

Furthermore, the parties are free to make a single choice of law for, or various choices of law for parts of, the receivables purchase agreement – the latter referred to as dépecage, which is possible only as an exception in case the parties have not specified a choice of law.

#### 3.2 Example 1: If (a) the seller and the obligor are located in Denmark, (b) the receivable is governed by the law of Denmark, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Denmark to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Denmark, will a court in Denmark recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

With regards to examples (1) to (5), Danish law distinguishes amongst the effectiveness of (i) the inter partes agreement entered into between the seller and the obligor (or the seller and a purchaser), which is regulated by the EC Convention on Law Applicable to Contractual Obligations (Rome 1980) as stated above, and (ii) any third party rights which remains unregulated.

Further, according to Danish private international law, any issue regarding the perfection and hence the effectiveness of the sale against third parties must be addressed with reference to the law of the country where the receivable is deemed to be located – referred to as the lex rei sitae rule. It is unresolved in Danish law whether a receivable (such being non-negotiable) is located at the obligor’s or the seller’s domicile as it does not relate to any physical location. There is no decisive case law on the subject and the legal scholars seem to be divided on this question, however, the predominant position is the domicile of the obligor. As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirement in both countries in case they differ.

Consequently, a Danish court will recognise a sale as being effective against third parties if the obligor and the seller are located in Denmark, and provided that the Danish perfection requirements are complied with.

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Denmark, will a court in Denmark recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Provided that the perfection requirements under Danish law have been complied with, but a Danish court rules that the perfection requirements shall be subject to foreign law with reference to the obligor’s domicile outside Denmark, the sale will not be effective against third parties (if foreign requirements are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirements in both countries in case they differ.

If the obligor is located in Denmark, please see question 3.2, above.
As regards the domicile of the purchaser, this will not interfere with the perfection requirements as this will be a matter of the domicile of either the obligor or the seller.

3.4 Example 3: If (a) the seller is located in Denmark but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Denmark recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Denmark’s own sale requirements?

Provided that the perfection requirements under the foreign law have been complied with, and a Danish court rules that the perfection requirements shall be subject to foreign law with reference to the domicile of the obligor outside Denmark, the sale will be effective against third parties.

Provided that the perfection requirements under the foreign law have been complied with, but a Danish court rules that the perfection requirements shall be subject to Danish law with reference to the domicile of the seller in Denmark, the sale will not be effective against third parties (if Danish requirements are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirement in both countries in case they differ.

As regards the domicile of the purchaser, this will not interfere with the perfection requirements as this will be a matter of the domicile of either the obligor or the seller.

3.5 Example 4: If (a) the obligor is located in Denmark but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Denmark recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Denmark’s own sale requirements?

Provided that the perfection requirements under the foreign law have been complied with, and a Danish court rules that the perfection requirements shall be subject to foreign law with reference to the domicile of the obligor outside Denmark, the sale will be effective against third parties.

Provided that the perfection requirements under the foreign law have been complied with, but a Danish court rules that the perfection requirements shall be subject to Danish law with reference to the domicile of the obligor in Denmark, the sale will not be effective against third parties (if Danish requirements are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirement in both countries in case they differ.

As regards the domicile of the purchaser, this will not interfere with the perfection requirements as this will be a matter of the domicile of either the obligor or the seller.

3.6 Example 5: If (a) the seller is located in Denmark (irrespective of the obligor’s location), (b) the receivable is governed by the law of Denmark, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Denmark recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Denmark and any third party creditor or insolvency administrator of any such obligor)?

The sale will not be effective against third parties as a Danish court will base its decision upon the perfection requirements in either the seller’s country (i.e., Denmark) or the obligor’s country, and not the perfection requirement in the purchaser’s country. Thus, the perfection requirements will not be satisfied (if Danish or the foreign laws of the obligor are more extensive).

As a precautionary measure we recommend that the seller (or the purchaser) complies with the perfection requirements of the seller’s and the obligor’s respective countries in case they differ.

4 Asset Sales

4.1 Sale Methods Generally. In Denmark what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

Generally, the seller and the purchaser will enter into a receivables purchase (or transfer) agreement governing the sale of the receivables. An assignment agreement is usually referred to in terms of a secured loan.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Notice to the obligor constitutes perfection in respect of sale of receivables; however, there are no specific requirements as to the form of notice and it may be served orally or in writing.

In addition hereto, we also recommend that the seller is deprived of the control over the receivable as well as over the income deriving from the receivable. Although this is not as such a perfection requirement in relation to true sale, it is a useful precautionary measure, should the sale be re-characterised as a secured loan which would not otherwise have been duly perfected.

Once the perfection requirements are fulfilled, the sale will not only be effective against the seller’s creditors but also against any subsequent good faith purchasers.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In respect of a sale of promissory notes or other negotiable documents, the sale is, strictly speaking, already perfected once the parties have entered into the transfer agreement (or once the notes,
etc., have been set aside for the purchaser). However, we recommend that the seller is also deprived of the control over the document either by the purchaser taking it into his own custody or by placing it in a third party’s custody as a useful precautionary measure, should the sale be re-characterised as a secured loan which would not otherwise have been duly perfected.

In respect of mortgage on real property, the sale must be registered with the Danish Land Registry in order to be perfected. This also applies in terms of chattel mortgages or car loans as the sale of such must be registered with the Danish Registry of Chattel Mortgages or the Danish Registry of Motor Vehicles, respectively.

Pursuant to the provisions of the Danish Consumer Credit Act, a consumer credit loan can only take the form of a non-negotiable document whereby the perfection requirement is notice to the obligor.

In Denmark, marketable debt securities will normally be dematerialised, i.e., they will only exist in the form of an electronic registration with the Danish securities depository – the VP Securities Services. A sale of such securities is perfected by way of registration with the VP Securities Services.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Yes, notice to the obligor is a perfection requirement and must be served by the seller or the purchaser.

No consent is required from the obligor (unless otherwise specifically required for in the receivable). An acknowledgment, although not required, would minimise the procedural risk of specifically required for in the receivable). An acknowledgment, although not required, would minimise the procedural risk of

No particular requirements apply to the form of notice or to the effective service, as it may be served orally or in writing. Danish law operates on the basis of substance over form; however, the notice must be clearly defined and precise in order for the obligor to become fully aware of the transfer. The notice must reach the obligor in order for perfection to be duly obtained, and that burden of proof lies with the one serving the notice. In addition, it may be required that foreign obligors are notified in their languages.

Normally, a notice is delivered in connection with or following the sale, but it may be delivered earlier if the receivable(s) can be clearly specified and identified. The delivery of a notice after insolvency proceedings against the seller have commenced is ineffective against the insolvent estate of the seller and the receivable(s) would then form part thereof. The delivery of a notice after insolvency proceedings against the obligor have commenced do not hinder an effective sale against third parties; however, in practice, the insolvent estate of the obligor would be unable to pay the receivable(s) in full (i.e., the purchaser will be non-preferential creditor).

A notice may apply to a specific receivable or to any and all (including future) receivables provided that the future receivables can be clearly identified, and this requirement is deemed satisfied to a greater extent if the sale relates to all future receivables in respect of an obligor, however, Danish case law is ambiguous on the scope of one single notice and it may be deemed ineffective.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Denmark? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Denmark recognises prohibitions of sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract on any other basis?

Generally, clauses prohibiting sale or assignment are enforceable in Denmark and must be adhered to by the parties.

As of 1 October 2011, a special securitisation scheme is available for financial institutions in Denmark under the Danish Securities Act, pursuant to which the Danish National Bank may provide funding to a financial institution against obtaining security interests in certain assets of that financial institution (e.g., loans, overdraft facilities, and securities – not including accounts receivables) subject to a haircut. Perfection is made by way of the financial institution forwarding a list of the secured assets to the Danish National Bank, and thereby dispensing from the requirement of notification.

In terms of a breach of prohibitions on sale or assignment, the seller will be liable for breach of contract. Furthermore, the obligor will not be bound by such sale or assignment and the purchaser will normally not be liable for the breach as no contract exists between the purchaser and the obligor.
4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The receivables purchase agreement has to individualise and identify the receivables sold in such detail that the purchaser is able at any time to identify which receivables have been bought. A sales agreement pursuant to which the seller sells all of its receivables (other than those owing by specifically identified obligors) is usually deemed to be sufficient identification of the receivables being sold, but it would obviously strengthen the structure if further characteristics of the receivables could be identified. No specific information requirements apply.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

A formal sale of receivables could be re-characterised as a secured loan if the substance of the sale corresponds to that of a secured loan, as Danish law applies substance over form – thus, a Danish court would not automatically give effect to the intent of the parties. In assessing this, one should take all aspects of the transfer into account and not just rely on a few factors. It is evident that the economic effects of such transfer are key factors in making this determination. In this respect, the Danish courts will be likely (although there is practically no case law to rely on) to re-characterise a sale as a secured loan if the risk and benefits in relation to the receivables in general remain with the seller.

In the event of a sale of receivables in which (a) the vast majority of the credit risk and to a lesser extent the interest risk remain with the seller, and (b) where the purchaser is restricted from exercising full ownership rights over the receivables, e.g., the right to freely dispose of the receivables to a third party, is more likely to be re-characterised as a secured loan than a sale, which does not exhibit these characteristics.

In relation to (c) the control of the collections of receivables will not per se have a direct bearing on the re-characterisation issue, however, should the sale be re-characterised as a secured loan (i.e., the characteristics described in item (a) and (b) above apply), then the perfection requirements, in terms of depriving the seller of the control over the receivables as well as the income deriving from such, are not fulfilled. As a precautionary measure, we recommend that the seller is deprived of the control over the receivables as well as the income deriving from such, unless the collection is made under strict supervision by the purchaser.

In relation to (d) a right of repurchase/redemption does not affect the perfection, but it may, subject to the terms and conditions hereof, jeopardise the ‘true sale’ characterisation and be re-characterised as a secured loan (cf. (a) and (b) above). Particularly, an obligation of repurchase/redemption with respect to defaulted receivables is deemed to weaken the ‘true sale’ characterisation considerably. The terms and conditions of the repurchase/redemption should not effectively mean that the vast majority of the credit risk remains with the seller.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, a seller can enter into an enforceable transfers transfer agreement in relation to the continuous sale of receivables. However, there may be circumstances where a continuous sale is not enforceable against third parties, cf. questions 4.5 and 4.10. Furthermore, it may be preferable for the purchaser to have a negative pledge registered in respect of the seller in the Danish Chattel Mortgage Registry (it requires the seller to be a company) if the seller grants a floating charge to one of its creditors which may give rise to conflicts of priority in respect of the receivables. Perfection thereof is subject to a stamp duty of approximately EUR 200.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The seller can, to a certain extent, enter into a receivable transfer agreement concerning future receivables provided that the contractual relationship between the seller and the obligor, which gives rise to these future receivables, can be described in extensive detail, i.e., an agreement for the sale of future receivables from a presently undefined group of obligors will not be enforceable. Thus, the problem is the perfection requirement in terms of notifying the obligors and depriving the seller of his control, which may qualify the enforceability of the transfer.

It remains unresolved if one single notice in respect of future receivables is sufficient perfection and if such is enforceable. As a precautionary measure, we recommend that the obligors are notified of the transaction of each individual receivable from-time-to-time.

If the transfers of the receivables, including the future receivables, are duly perfected, such receivables will not form part of the seller’s insolvency estate, cf. question 6.5 below, and non-perfected transfers would form part of the seller’s insolvency estate.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Generally, any related security could be transferred to the purchaser together with the receivable, e.g., any insurance or guarantees for payment of the receivable. The perfection requirement would, in such instances, be notice to the relevant insurance company and guarantor, etc.
5 Security Issues

5.1 Back-up Security. Is it customary in Denmark to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No, in Denmark, the main risk is not whether the sale has been perfected or not, but instead whether the relevant perfection requirements have been fulfilled should the sale be re-characterised as a secured loan. Therefore, most receivables transfer agreements in Denmark are structured in such a way that all perfection requirements are met irrespective of whether the sale is re-characterised or not.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Denmark, and for such security interest to be perfected?

In order to create a security interest over the receivables and any related security, the parties would have to enter into a pledge agreement in relation to these assets. The perfection requirement would be notice to the obligors along the same lines as in relation to true sale. In addition, the seller must be deprived of the control over the receivables, as well as over any income deriving from these receivables.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Denmark to grant and perfect a security interest in purchased receivables governed by the laws of Denmark and the related security?

As regards security interest over the purchased receivables and any related security, the purchaser must comply with the requirements set out in question 5.2.

Pursuant to the Danish Registration Act, no person may grant security interests over all of his present or future assets, whereby the purchaser is unable to grant security interests over all of its assets. As an exemption, the purchaser may grant a floating charge over some of its assets (including receivables, intellectual property, etc.) by way of registering an all-mones mortgage in the Danish Registry of Chattel Mortgages. Perfection is subject to a stamp duty of approximately EUR 200 and an additional 1.50 per cent of the nominal amount of the all-mones mortgage.

In the event that the purchaser is to grant security over any specific assets, the perfection requirements may differ as different acts of perfection apply to the various types of assets.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Denmark, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Denmark or must additional steps be taken in Denmark?

Subject to the qualifications set out in question 2.3, the security interest granted will be considered valid between the purchaser and the relevant third party.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

In order to create a valid and perfected security interest over a promissory note or any other negotiable document, the parties have to enter into a pledge agreement. In addition hereto, the pledgee will also have to deprive the pledgor of the control over the relevant document, either by taking it into his own custody or by transferring it to a third party. In relation to marketable debt securities, the perfection requirement is registration of the security interest in the VP Securities Centre.

5.6 Trusts. Does Denmark recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

A trust cannot be established under Danish law and the concept of trust is not generally recognised under Danish law, however, the existence of a validly created trust under foreign law may be recognised in Denmark as a matter of Danish conflict of law rules. The concept of agency is recognised under Danish law, whereby a single legal entity may be appointed to act as agent on behalf of others and hold the receivables, collect the payments made or enforce any security granted. An agency contract (e.g., power of attorney) should define the agent’s authority.

5.7 Bank Accounts. Does Denmark recognise escrow accounts? Can security be taken over a bank account located in Denmark? If so, what is the typical method? Would courts in Denmark recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Denmark?

Yes, Denmark recognises escrow accounts.

Yes, security may be taken over a bank account located in Denmark and is perfected by way of notification to the account bank and depriving the pledgor control of the bank account. Thus, the pledged bank account must be blocked and the pledgor’s access must be made subject to discretionary consent of the pledgee.

No, the Danish courts will not recognise a foreign-law grant of security over an asset located in Denmark as any issue regarding third party rights must be addressed in accordance with the lex rei sitae rule, which, in this event, will refer to Danish law provided.
that the perfection requirement of a bank account pledge in the
foreign country is not similar to those in Denmark.

5.8 Enforcement over Bank Accounts. If security over a bank
account is possible and the secured party enforces "security, does the secured party control all cash flowing
into the bank account from enforcement forward until the
secured party is repaid in full, or are there limitations? If
there are limitations, what are they?"

Yes, security may be created over bank accounts and the balance
from time-to-time standing to the credit of the pledgor, including
interest. Upon enforcement of the security, the secured party will
control all cash flowing into the pledged account until being repaid
in full. Provided that no amount transferred to the account is
earmarked, e.g., insurance proceeds, or subject to limitations in the
bank accounts pledge agreement, no material limitations apply.

5.9 Use of Cash Bank Accounts. If security over a bank
account is possible, can the owner of the account have
access to the funds in the account prior to enforcement
without affecting the security?

Yes, security may be created over bank accounts; however, it is a
perfection requirement that the pledgor is deprived of the control of
the bank accounts, including the balance standing to the credit of it.
If the pledgor is not deprived of the control, the pledge will not be
effective against third parties. This requirement may be
inconvenient for the pledgor, and it may be solved by permitting the
pledgor to operate a parallel (non-pledged) bank account into which
amounts from the pledged bank accounts may be transferred with
the consent of the secured party.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is
otherwise perfected, the seller becomes subject to an
insolvency proceeding, will Danish insolvency laws
automatically prohibit the purchaser from collecting,
transferring or otherwise exercising ownership rights over
the purchased receivables (a "stay of action")? Does the
insolvency official have the ability to stay collection and
enforcement actions until he determines that the sale is
perfected? Would the answer be different if the purchaser
is deemed to only be a secured party rather than the
owner of the receivables?

If a true sale of the receivables is upheld and has been duly perfected
and is not subject to any reversibility, the receivables will not form part
thereof and the purchaser may continue to exercise any ownership
rights without any involvement of the seller’s insolvency estate.
If a security interest over the receivables has been duly perfected
and is not subject to any reversibility, the purchaser is a secured
preferential creditor with preference to enforce the security interest
directly without any involvement of the seller’s insolvency estate.

6.2 Insolvency Official’s Powers. If there is no stay of action
under what circumstances, if any, does the insolvency
official have the power to prohibit the purchaser’s
exercise of rights (by means of injunction, stay order or
other action)?

Under the precondition that (i) the sale is upheld as a true sale and
not subject to any reversibility, or (ii) the security interest is duly
perfected and not subject to any reversibility, the insolvency official
will have no such powers.

6.3 Suspect Period (Clawback). Under what facts or
circumstances could the insolvency official rescind or
reverse transactions that took place during a “suspect” or
“preference” period before the commencement of the
insolvency proceeding? What are the lengths of the
“suspect” or “preference” periods in Denmark for (a)
transactions between unrelated parties and (b)
transactions between related parties?

Generally, an otherwise duly perfected transaction could be
reversed if the transfer is preferential towards one creditor or if it
diminishes the pool of assets which would otherwise form part of
the insolvency estate. The reversibility may relate to (i) gifts, (ii)
payments, and (iii) security interest.

(i) Any gift to the purchaser may be voided by the insolvency
official if such is made six months prior to the adjudication
of insolvency. In case a gift is received by a party related to
the obligor, the preference period is extended to one year.

(ii) Any payment made to the purchaser may be voided by the
insolvency official if such is made three months prior to the
adjudication of insolvency provided that the payment is
made (a) by abnormal means, (b) prior to the debt being due,
or (c) with the effect of decisively deteriorating the obligor’s
ability to pay. If payment is made to a party related to
the obligor, the preference period is extended to two years.

(iii) Any security granted to the purchaser for the security of
existing debt may be voided by the insolvency official if such
is issued three months prior to the adjudication of insolvency.
In case a security is granted to a party related to the
obligor, the preference period is extended to two years.

Furthermore, a general clause exists in which the insolvency official
may reverse transactions in a period which is – in principle –
unlimited.

6.4 Substantive Consolidation. Under what facts or
circumstances, if any, could the insolvency official
consolidate the assets and liabilities of the purchaser with
those of the seller or its affiliates in the insolvency
proceeding?

In general, Danish corporate law distinguishes between the
purchaser, the seller and its affiliates each as being separate legal
entities, whose rights and liabilities must be addressed separately.
The Danish courts in some cases deviated from this in case the
economy and management of entities have been interconnected to
such an extent that the boundaries of the legal entities become
blurred, or if the entities have tried to take advantage of the
corporate structure and its limited liability in order to favour certain
creditors.

6.5 Effect of Proceedings on Future Receivables. If
insolvency proceedings are commenced against the seller
in Denmark, what effect do those proceedings have on (a)
sales of receivables that would otherwise occur after the
commencement of such proceedings or (b) on sales of
receivables that only come into existence after the
commencement of such proceedings?

Upon the adjudication of insolvency, the insolvency official will be
put in charge of the seller’s assets which form part of the insolvency
estate, including any receivable transfer agreement entered into by
the seller (e.g., the right to receive payment thereafter). If such
agreement concerns the sale of future receivables and is valid, cf. question 4.10, and does not constitute a preference, the insolvency official can either choose to terminate the contract or to honour it.

In respect of the latter option, the agreement will have a preceding position in the insolvency proceedings but the number of future receivables will decline as the insolvency official is winding-up the business of the seller, which gives rise to the receivables.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Denmark establishing a legal framework for securitisation transactions? If so, what are the basics?

No, Denmark has not adopted any special securitisation legislation, whereby it is conducted on the basis of general contract law.

7.2 Securitisation Entities. Does Denmark have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No, Denmark has not adopted any special legislation in respect of such special purpose entities. However, any entities which (i) purchase any receivables or other assets from an originator, and (ii) fund their acquisitions by issuing bonds to the general public in Denmark might become subject to the provisions of the Danish Financial Business Act.

7.3 Non-Recourse Clause. Will a court in Denmark give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Yes, in general the Danish courts will give effect to such a contractual provision, unless the courts deem it to be unreasonable.

7.4 Non-Petition Clause. Will a court in Denmark give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Yes, in general the Danish courts will give effect to such a contractual provision, unless the courts deem it to be unreasonable.

7.5 Priority of Payments “Waterfall”. Will a court in Denmark give effect to a contractual provision (even if the contract’s governing law is the law of another country) specified in the contract?

A Danish court will give effect to a “waterfall” provision provided that the choice of foreign law is a valid choice of law made in accordance with the EC Convention on Law Applicable to Contractual Obligations (Rome 1980) and subject to the qualifications set out in question 2.3.

7.6 Independent Director. Will a court in Denmark give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

No, as the directors of a Danish company are under a statutory duty to safeguard the interests of the shareholders, as well as the interests of the company’s creditors, this duty cannot be limited by way of agreement or otherwise and any attempt to act in accordance with such an agreement could subject the directors of the company to liability towards the shareholders and/or the creditors of the company.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Denmark, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Denmark? Does the answer to the preceding question change if the purchaser does business with other sellers in Denmark?

Generally, purchase, ownership or enforcement of Danish receivables, as well as the collection of these receivables, will not per se qualify as doing business in Denmark and will not require any licences or authorisations under the Danish Financial Business Act.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

If the seller enforces and collects the receivables following the transfer to the purchaser, the seller will require a licence pursuant to the Danish Debt Collection Act, which will also be required in case of any third party replacement servicer, however, not applicable to attorneys at law. A licence will not be required if the seller enforces and collects the receivables prior to the transfer to the purchaser.

8.3 Data Protection. Does Denmark have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Danish Data Protection Act applies to the processing and dissemination of personal data relating to private individuals whether being consumers or not and to some extent to corporate entities (primarily in relation to the processing of credit information by credit agencies).

According to the provisions of the act, personal data may only be gathered for specifically stated purposes and must be processed in accordance with good data processing practice.

In addition hereto, the processing of data as well as the dissemination of data will often require the consent of the relevant person, especially in cases where the data is transferred to third countries outside of the European Economic Area, which do not have an adequate level of data protection.
8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Denmark? Briefly, what is required?

Consumers are protected by the Danish Consumer Contract Act, and depending on the nature of a securitisation, the receivables may often be subject to the provisions of the Danish Consumer Contract Act, which applies generally to consumer credit agreements. The Act contains various provisions in respect of interest rate fixing, calculation of costs and prepayment options, as well as a number of information requirements, which the purchaser will have to comply with, cf. question 1.2 above.

8.5 Currency Restrictions. Does Denmark have laws restricting the exchange of Danish currency for other currencies or the making of payments in Danish currency to persons outside the country?

Apart from payments to persons in countries under embargos or sanctions imposed by the United Nations and/or the European Union, there are no restrictions to the exchange of the Danish currency (DKK).

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Denmark? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments on receivables by obligors to either a purchaser or a seller are not subject to withholding taxes provided that neither the purchaser nor the seller has any permanent establishment in Denmark in regards to the sale of the receivables.

9.2 Seller Tax Accounting. Does Denmark require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No specific accounting policy is required in the context of securitisation. Good accounting practice is a legal standard in Denmark which all accountants must follow.

9.3 Stamp Duty, etc. Does Denmark impose stamp duty or other documentary taxes on sales of receivables?

No, there is no stamp duty or documentary taxes on the sale of receivables. As stated in question 5.3 above, a security interest over the receivables created as a floating charge will be subject to a stamp duty.

9.4 Value Added Taxes. Does Denmark impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Value Added Tax (VAT) of 25 per cent is as a starting point due on any sold goods or services made in Denmark, where it is a taxable supply made by a taxable person in the course or furtherance of a business carried on by said person.

Sales of receivables are VAT exempt in Denmark.

Collection agent services are subject to VAT in Denmark.

VAT on the sold goods or services made in Denmark may only be deducted by the seller of the goods or services if a loss is accrued on the receivable. A purchaser of a receivable is not allowed to deduct VAT if a loss is accrued on the obligor, as the purchaser is not subject to any gain realised on the receivable, cf. question 9.5 below.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

The seller alone is responsible for the payment of VAT and excise duties. No claims for indirect taxes can be made against the purchaser of the liabilities.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Denmark, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Denmark?

Under the precondition that the purchaser does not have any permanent establishment in Denmark, the mere ownership and collection of the receivables will not make the purchaser liable to Danish taxation.
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Accura’s Banking and Finance Group represents some of the most active foreign and domestic players in the Danish market for banking and financial services. Our practice is focused on acquisition finance, property finance, structured finance, securities, financial institutions and investment funds.

Accura’s Banking and Finance Group provides regular advisory services to market-leading European companies in respect of the legal problems relating to securitisation under Danish law, and offer expertise in connection with the securitisation of mortgages, securities, receivables, credit card, leasing activities, etc.
Chapter 15

England & Wales

Weil, Gotshal & Manges

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

With the exception of certain debts arising under regulated consumer credit arrangements, a debt need not be in writing to be enforceable against the obligor but must arise as a matter of contract or deed. Contracts may be written, oral or partly written and partly oral. An invoice (depending on its terms) may itself represent the contract between the parties or evidence a debt arising pursuant to such a contract. Where a contract is oral, evidence of the parties’ conduct is admissible for the purposes of ascertaining the terms of the contract. A contract may be implied between parties based on a course of conduct or dealings where the obligations arising from the alleged implied contract are sufficiently certain to be contractually enforceable.

1.2 Consumer Protections. Do the laws of England & Wales: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Consumer credit loans are regulated by the Consumer Credit Act 1974, as amended by the Consumer Credit Act 2006 and the implementation of the Consumer Credit Directive in 2010 (together the “CCA”). There is no maximum interest rate set out by the legislation. It is unlikely that courts will find interest rates unfair unless they are clearly excessive. There is a statutory right to interest on late payments but this does not apply to consumer credit agreements.

Certain clauses of receivables contracts may be found to be unfair under the Unfair Terms in Consumer Contracts Regulations 1999 (“UTCCR”) and consequently may be unenforceable against the consumer. The Consumer Protection from Unfair Trading Regulations prohibit certain practices that are deemed unfair.

In January 2012, the United Kingdom government announced that it was including provisions into the new Financial Services Act 2012 to enable the transfer of consumer credit regulation from the Office of Fair Trading (“OFT”) to the successor of the Financial Services Authority (“FSA”), the UK Financial Conduct Authority (the “FCA”), a process which will occur in phases starting in April 2014 and ending in full implementation in April 2016.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Not specifically, although there may be enforcement issues as a result of the laws pertaining to sovereign immunity.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in England & Wales that will determine the governing law of the contract?

For contracts entered into between 1 April 1991 and 16 December 2009, the relevant law is the Contracts (Applicable Law) Act 1990, which enacted the Rome Convention on the law applicable to contractual obligations (80/034/EEC) (“Rome Convention”) in England and Wales. For contracts entered into on or after 17 December 2009, the position is governed by Regulation 593/2008/EC of 17 June 2008 (“Rome I”).

The Rome Convention states that, absent an express choice of law, the applicable law of a contract will be that of the country with which it has the closest connection. There is a presumption that this will be the country where the party who is to effect the performance of the contract has his habitual residence (if an individual) or its central administration (if a corporate entity). However, if the contract is entered into in the course of that party’s trade or profession, the country with the closest connection is the country in which the party’s principal place of business is situated. Where, under the terms of the contract, the performance is to be effected through a place of business other than the principal place of business, it is the country in which that other place of business is situated. There is a presumption that the contract is more closely connected with another country. It should also be noted that certain classes of contracts fall outside the scope of the Rome Convention.

Under Rome I, the position is largely the same, save that the presumption in favour of the law of the place where the party effecting performance has his habitual residence is a fixed rule. This fixed rule may be displaced if the contract falls into one of
several defined classes (for which specific rules apply) or if the contract is manifestly more closely connected with the law of a different country (in which case the law of that country is the applicable law) or if it is sufficiently certain from the terms or circumstances of the contract which law the parties chose to apply (in which case that law will be the applicable law).

For those types of contract which fall outside the scope of the Rome Convention or Rome I, the applicable law will be decided by reference to English common law principles. Those principles seek first to determine which law the parties intended to govern the contract. If no such intention can be established, the applicable law of the contract is that with which the contract has its closest and most real connection, in light of all the material circumstances. In deciding this, the English courts will consider which law the ordinary businessman would have intended to apply.

2.2 Base Case. If the seller and the obligor are both resident in England & Wales, and the transactions giving rise to the receivables and the payment of the receivables take place in England & Wales, and the seller and the obligor choose the law of England & Wales to govern the receivables contract, is there any reason why a court in England & Wales would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in England & Wales but the obligor is not, or if the obligor is resident in England & Wales but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in England & Wales give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Both the Rome Convention and Rome I stress the importance of the parties’ freedom to choose the law of their contract (including a foreign law). This choice can be express or implied. The Rome Convention and Rome I allow for modification of the parties’ choice only: (i) where all elements of a contract are connected to a country other than the country whose law has been chosen by the parties and that country has rules which cannot be disobeyed by contract (in which case the court will apply those rules); (ii) to the extent that the law chosen conflicts with overriding mandatory rules of English law (as the law of the forum); or (iii) where the applicable foreign law is manifestly incompatible with English public policy. Additionally, under Rome I, the English courts will modify the parties’ choice of law where the overriding mandatory rules of the place of performance render performance of the contract unlawful.

For those types of contracts not within the scope of the Rome Convention or Rome I, the common law is also highly supportive of the parties’ choice of a foreign law and will only modify such a choice in exceptional circumstances.


No, it is not.
3.4 Example 3. If: (a) the seller is located in England & Wales but the obligor is located in another country; (b) the receivable is governed by the law of the obligor’s country; (c) the seller sells the receivable to a purchaser located in a third country; (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement; and (e) the sale complies with the requirements of the obligor’s country, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with England & Wales’ own sale requirements?

Under the Rome Convention and Rome I, the validity of a contract will be determined by reference to the governing law of that contract as chosen by the parties. In assessing the validity of the receivables purchase agreement, the English courts would apply the governing law of the receivables purchase agreement (in this case the law of the obligor’s country) and as to perfection of the sale, the governing law of the receivables (in this case also the law of the obligor’s country). However, as discussed in question 2.3 above, certain mandatory principles of England and Wales (such as mandatory principles of insolvency law in the seller’s insolvency) would not be capable of disapplication by the parties’ choice of a foreign law and the courts would not apply the parties’ chosen law to the extent it conflicted with those mandatory principles, or was manifestly incompatible with public policy.

3.5 Example 4. If: (a) the obligor is located in England & Wales but the seller is located in another country; (b) the receivable is governed by the law of the seller’s country; (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement; and (d) the sale complies with the requirements of the seller’s country, will a court in England & Wales recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with England & Wales’ own sale requirements?

See questions 3.1 and 3.4 above. The English courts would recognise the sale as effective against the obligor to the extent that it complied with the requirements of the governing law of the receivables (in this case, the law of the seller’s country).

3.6 Example 5. If: (a) the seller is located in England & Wales (irrespective of the obligor’s location); (b) the receivable is governed by the law of England & Wales; (c) the seller sells the receivable to a purchaser located in a third country; (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement; and (e) the sale complies with the requirements of the purchaser’s country, will a court in England & Wales recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with England & Wales’ own sale requirements?

See questions 3.1 – 3.5 above. The sale would be effective against the seller provided it complied with the perfection requirements of the governing law of the receivables (in this case English law) whilst certain principles of English law may apply to govern the relationship between the purchaser and the obligor and in any insolvency proceedings of the seller and/or obligor in England and Wales.

4 Asset Sales

4.1 Sale Methods Generally. In England & Wales what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The most common method of selling receivables is by way of assignment (either legal or equitable). Alternatives to assignment include a trust over the receivables (coupled with a power of attorney), a trust over the proceeds of the receivables, sub-participation (essentially a limited recourse loan to the seller in return for the economic interest in the receivables) and novation (a transfer of both the rights and obligations under the contract). An outright sale of receivables may be described as a “sale” or “true sale”, a “transfer” or an “assignment”, although “assignment” most often indicates a transfer of rights but not obligations, whilst “transfer” often indicates a transfer of rights and obligations by novation. The phrase “security assignment” is often used to distinguish a transfer by way of security from an outright assignment.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

To perfect an assignment of receivables express notice in writing is required to be given to the obligor. The giving of such notice will not in itself result in the assignment becoming a legal, rather than equitable, assignment as certain other formalities are also required under s.136 of the Law of Property Act 1925 (“LPA”), namely the assignment has to be: (i) in writing and signed by the assignor; (ii) of the whole of the debt; and (iii) absolute and unconditional and not by way of charge. Where the sale of a receivable falls short of these requirements it will take effect as an equitable assignment and any subsequent assignment effected by the seller and notified to the obligor prior to the date on which the original assignment is notified to the obligor, will take priority. A novation of receivables (pursuant to which both rights and obligations are transferred) requires the written consent of the obligor as well as the transferee and transferor.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

The transfer requirements for promissory notes (as well as other negotiable instruments) are governed by the Bills of Exchange Act 1882, which provides that they are transferable by delivery (or delivery and endorsement).

Mortgage loans and their related mortgages may be transferred by assignment. With respect to a mortgage over real property, as well as the giving of notice, certain other formalities need to be complied with in order to effect a legal assignment, for example registration of the transfer at H.M. Land Registry as required by the Land Registration Act 2002. Most residential mortgage securitisations are structured as an equitable assignment of mortgage loans and their related mortgages to avoid the burdensome task of giving notice to the mortgagors and registering the transfer. However, until notice is given and the formalities satisfied, the rights of an assignee of a mortgage may be adversely affected by dealings in the underlying property or the mortgage, as described in question 4.4 below.
See questions 8.1 – 8.4 in relation to specific regulatory requirements in relation to consumer loans.

Transfers of marketable securities in bearer form will be achieved by delivery or endorsement and, if in registered form, by registration of the transference in the relevant register. Dematerialised marketable securities held in a clearing system represented by book-entries may be transferred by debiting the clearing system account of the relevant seller and crediting the clearing system account of the purchaser (or, in each case, its custodian or intermediary).

Specific statutory requirements may also apply for assignments of receivables such as intellectual property rights and certain policies of insurance.

4.4 Ombor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Assuming the receivable does not fall into a select category of contractual rights which are incapable of assignment either as a matter of public policy or because the rights are of a personal nature, in the absence of an express contractual prohibition on assignment, receivables may be assigned without notification to, or consent of, the obligor. To the extent that a receivable is the subject of a contractual prohibition on assignment, other methods of transfer may be available (see question 4.1 above) depending on the exact wording of the contract.

The absence of notice has the following implications: (i) obligors may continue to discharge their debts by making payments to the seller (being the lender of record); (ii) obligors may set-off claims against the seller arising prior to receipt by the obligors of the notice of assignment; (iii) a subsequent assignee of (or fixed chargeholder over) the receivables contract expressly prohibits assignment; or (iv) the sale from being perfected? Among other things, to respect for intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

There is no specific time limit for the giving of notices set down in the LPA and notice can be given to obligors post-insolvency of the seller (including pursuant to an irrevocable power of attorney granted by the seller) or of the obligor. The giving of such notice should not be prohibited by English insolvency law although failure to give notice will have the effects set out in question 4.4 above.

Restrictions on assignments or transfers of receivables are generally enforceable. If a contract is silent on assignability, then such contract and the receivables arising thereunder will be freely assignable. In very limited circumstances, such as upon the death of an individual, assignment may take place by operation of law, overriding an express contractual provision prohibiting assignment. It may be possible to utilise a trust arrangement where non-assignment provisions within contracts would otherwise prevent assignment.

If an assignment is effected in breach of a contractual prohibition on assignment, although ineffective as between the obligor and the seller (to whom the obligor can still look for performance of the contract), such assignment may still be effective as between the seller and purchaser in compliance with the governing law and explicit terms of the receivables purchase agreement.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in England & Wales? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If England & Wales recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

The sale document must describe the receivables (or provide for details of the receivables to be provided at the point of sale) with sufficient specificity that the receivables can be identified and distinguished from the rest of the seller’s estate. For confidentiality reasons, it is atypical for obligors’ names to be included in the information provided to the seller.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

A transaction expressed to be a sale will be recharacterised as a secured financing if it is found to be a “sham”, i.e. if the documents
do not reflect the actual agreement between the parties. Further, irrespective of the label given to a transaction by the parties, the court will look at its substance and examine whether it creates rights and obligations consistent with a sale.

Case law has established a number of key questions to be considered when concluding that a transaction is a true sale rather than a secured financing:

1) Do the transaction documents accurately reflect the intention of the parties and are the terms of the transaction documents consistent with a sale as opposed to a secured financing?
2) Does the seller have the right to repurchase the receivables sold?
3) Does the purchaser have to account for any profit made on any disposition by it of the receivables?
4) Is the seller required to compensate the purchaser if it ultimately realises the acquired receivables for an amount less than the amount paid?

However, a transaction may still be upheld as a sale notwithstanding the presence of one or more of these factors. As a result, the intention of the parties, their conduct after the original contract and the express terms of the contract will all be factors when a court decides, as a whole, whether or not a contract is inconsistent with that of a sale.

The seller remaining the servicer/collection agent of the receivables post-sale, the seller entering into arm’s length interest-rate hedging with the purchaser, the seller assuming some degree of credit risk by assuming a first loss position and the right of a seller to repurchase receivables in limited circumstances are not generally considered to be inherently inconsistent with sale treatment. The seller retaining an equity of redemption in respect of a transfer of receivables may, however, lead a court to the conclusion that the transaction is a security arrangement not an outright transfer.

If the sale is recharacterised as a secured financing, the assets “sold” will remain on the seller’s balance sheet and the loan will be shown as a liability of the seller. In addition, given the practice in England and Wales not to make “back-up” security filings, the security may not have been registered and may, therefore, be void in an insolvency of the seller for lack of registration (subject to the application of the FCR as referred to in question 5.3).

In addition to recharacterisation, sale transactions are also vulnerable under certain sections of the Insolvency Act 1986 such as those relating to transactions at an undervalue and preferences.

### 4.10 Future Receivables

Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

An assignment for value of an identifiable receivable, which is not in existence at the time of the receivables purchase agreement but which will be clearly ascertainable in the future, is treated as an agreement to assign which will give rise to an equitable assignment of the receivable as soon as it comes into existence. See the answer to question 6.5 on the effect of an insolvency of the seller on an agreement to assign a receivable not yet in existence.

### 4.11 Related Security

Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Security for a receivable will typically be capable of being assigned in the same manner as the receivable itself. The transfer or assignment of some types of security may require additional formalities such as registration or payment of a fee as referred to in question 4.3.

### 5 Security Issues

#### 5.1 Back-up Security

Is it customary in England & Wales to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary to create “back-up” security over a seller’s ownership interest in receivables and related security when an outright sale is intended although a seller may create a trust over the receivables in favour of the purchaser to the extent that any outright sale is later held to be void or is subsequently recharacterised.

#### 5.2 Seller Security

If so, what are the formalities for the seller granting a security interest in the related security and for such security interest to be perfected?

See questions 5.1 and 5.3.

#### 5.3 Purchaser Security

If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in England & Wales to grant and perfect a security interest in purchased receivables governed by the laws of England & Wales and the related security?

Although security may be taken over receivables by way of novation, attornment, pledge (in the case of documentary receivables) or by retention of title arrangements, security is most commonly taken over receivables by way of mortgage or charge.
Receivables assigned by way of security together with a condition for re-assignment on redemption of the secured obligation will create a mortgage over the receivables which will either be legal (if the procedural requirements of the LPA identified in question 4.2 are satisfied) or, in the absence of these requirements, equitable. Prior to the perfection of an equitable mortgage, the assignee’s security will be subject to prior equities (such as rights of set-off and other defences), will be liable to take priority behind a later assignment where the later assignee has no notice of the earlier assignment and himself gives notice to the obligor, and the obligor will be capable of making good discharge of its debt by paying the assignor directly (see questions 4.4 and 4.5).

Alternatively, the receivables may be made the subject of a fixed or floating charge. In comparison to a mortgage (which is a transfer of title together with a condition for re-assignment on redemption) a charge is a mere encumbrance on the receivables, giving the chargee a preferential right to payment out of the fund of receivables in priority to other claimants. A practical distinction between a mortgage and a charge over receivables is the inability of a chargee to claim a right of action in his own name against the obligor. In practice this distinction is diminished by including a right to convert the charge into a mortgage together with a power of attorney to compel transfer of the receivables to the chargee.

The degree of priority given to a chargee depends on whether the charge is fixed or floating. Whilst definitive definitions have remained elusive, the hallmarks of a fixed charge are that it attaches to the ascertainable receivables over which it is subject immediately upon its creation (or upon the receivable coming into existence). In comparison, a floating charge is a present security over a class or fund of assets (both present and future) which, prior to the occurrence of a specified crystallisation event, can continue to be managed in the ordinary course of the chargor’s business. On occurrence of a specified crystallisation event the floating charge will attach to the assets then presently in the fund, effectively becoming a fixed charge over those assets. Recent case law emphasises control of the receivable as the determining factor in distinguishing a fixed or floating charge whilst asserting that it is the substance of the secured created, rather than how described or named, that is important.

The distinction is important: on an insolvency of the chargor, a fixed chargeholder will rank in priority to all unsecured claims whilst a floating chargeholder will rank behind preferential creditors and fixed chargeholders and equally with a statutory “prescribed part” (up to a maximum of £600,000) made available to unsecured creditors; a floating charge given within 12 months (or 24 months if given to a “connected” person) prior to the onset of insolvency will be void except as to new value given; and whereas a fixed chargeholder will obtain an immediate right over definite assets which can only be defeated by a purchaser in good faith, a floating charge will attach to the assets then presently in the fund, effectively becoming a fixed charge over those assets.

The procedural requirements of the LPA identified in question 4.2 require a company registered in England or Wales (with some very limited exceptions) to register the original copy of the instrument creating a mortgage/charge at Companies House if the company has registered the particulars of an asset. The mortgage/charge is then registered within the statutory 21-day period after creation, a registration which will apply whether the charge is over an asset in or outside of the UK. Where certain security arrangements exist over financial collateral (cash, financial instruments and credit claims) between two non-natural persons, the Financial Collateral Arrangements (No. 2) Regulations 2003 (as amended, including pursuant to the Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendments) Regulations 2010 that came into force in England and Wales on 6 April 2011) (the “FCR”) which implement EU Directive 2002/47/EC into English law, disapply certain statutory requirements in relation to that security arrangement (such as the requirement to register security at Companies House under the Companies Act or overseas companies registration requirements noted above as well as certain provisions of English insolvency law).

Except as noted above with regard to the FCR, failure to register a mortgage/charge within the prescribed statutory period will (both pre and post 6 April 2013) result in that security interest being void as against a liquidator, administrator, creditors in a liquidation or as against a company on/after 1 October 2011 over UK assets is not required to be registered at Companies House although such overseas company must, within 21 days of the creation of any mortgage/charge over UK land, ships, aircraft and intellectual property registered in the UK, or any floating charge over any of its property (unless UK property is expressly excluded), enter details of such mortgage/charge on its charges register. This register must be available for inspection, as must copies of the instruments creating any such mortgage/charge.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of England & Wales, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in England & Wales or must additional steps be taken in England & Wales?

Notwithstanding the choice of law governing the purchaser’s security, the law governing the receivable itself will govern the proprietary rights and obligations between the security holder and the obligor and between the security grantor and the security holder (including as to matters of validity, priority and perfection).
The relevant security must therefore be valid and perfected under the laws of England and Wales as well as valid and perfected under the laws of the governing law of the security in order for it to be given effect by the English courts. In addition, English courts will also apply certain mandatory rules of English law which may affect the validity of any foreign law governed security created.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security over contractual rights under insurance policies are usually created by security assignment. Security over mortgage or consumer loans will be created by mortgage or charge. Creating security over the mortgage securing a mortgage loan is generally accomplished by equitable mortgage.

Security over marketable debt securities or negotiable instruments (including promissory notes and bearer debt securities) is a complicated area that depends on whether the relevant securities are bearer or registered, certificated, immobilised (i.e. represented by a single global note) or dematerialised and/or directly-held or indirectly-held. In (brief) summary: (i) directly-held and certificated debt securities, where registered, may generally be secured by legal mortgage (by entry of the mortgagee on the relevant register) or by equitable mortgage or charge (by security transfer or by agreement for transfer or charge); (ii) security over bearer debt securities may be created by mortgage or pledge (by delivery together with a memorandum of deposit) or charge (by agreement to charge) and in certain limited circumstances a lien may arise; and (iii) security may be created over indirectly-held certificated debt securities by legal mortgage (by transfer, either to an account of the mortgagee at the same intermediary or by transfer to the mortgagee’s intermediary or nominee via a common intermediary) or by equitable mortgage or charge (by agreement of the intermediary to operate a relevant securities account in the name of the mortgagor containing the debt securities to the order/control of the chargee).

To the extent the security is of a type specified in the Companies Act, it may, prior to 6 April 2013, be required to be registered at Companies House. The FCR (which remove certain requirements in relation to the creation and registration of security and disapply certain rules of insolvency law) will apply to any security which is a “financial collateral arrangement” involving “financial collateral”. See question 5.3.

5.6 Trusts. Does England & Wales recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Trusts over collections received by the seller in respect of sold receivables are recognised under the laws of England and Wales provided that the trust is itself validly constituted.

5.7 Bank Accounts. Does England & Wales recognise escrow accounts? Can security be taken over a bank account located in England & Wales? If so, what is the typical method? Would courts in England & Wales recognise a foreign-law grant of security taken over a bank account located in England & Wales?

English law recognises the concept of money held in a bank account in escrow. Security granted by a depositor for a third party is typically taken over the debt represented by the credit balance by way of charge or (where the securityholder is not also the same bank at which the cash is deposited) a security assignment. Security over a credit balance granted in favour of the bank at which the deposit is held can only be achieved by way of charge (not by assignment) and is usually supplemented by quasi-security such as a flawed asset arrangement, a contractual right of set-off and a charge in favour of the bank over the depositor’s claims for payment of the deposit. To the extent that the security is a security financial collateral arrangement over cash, as provided for in the FCR, those regulations will apply.

Foreign-law governed security over a bank account located in England and Wales must be valid under the laws of England and Wales as well as its own governing law in order for it to be given effect by the English Courts.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

This is a complicated question that will depend upon (amongst other things) the nature of the security over the account (whether on its facts it is a fixed or floating charge or a security assignment), whether there are any competing security interests or trust arrangements over the account and the extent of any commingling of cash, whether any security interest is also a security financial collateral arrangement under the FCR and whether the account holder is the subject of insolvency proceedings. Where a security financial collateral arrangement under the FCR exists, the parties may agree the collateral-taker can appropriate the financial collateral, giving the right to become the absolute owner of the collateral should the security become enforceable.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Any charge over the account is likely to be a floating charge rather than a fixed charge on these facts because the chargee is unlikely to have sufficient control over the account in order to create a fixed charge. The ramifications of this distinction are set out in question 5.3.

Whether an English law floating charge can be a security financial collateral arrangement under the FCR (with the advantages that this may bring to a chargeholder) has been the subject of recent case law focusing on the FCR requirement that the charged collateral be in the possession and control of the collateral-taker. The resulting lack of clarity has led to the Financial Markets Law Committee establishing the Bank of England publishing a paper in early 2013 urging clarification.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the insolvency laws of England & Wales automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Most formal insolvency procedures have an automatic stay of action against the insolvent entity. If the right to the receivables has been transferred by legal assignment, the sale will be perfected, the purchaser will have the right to enforce his assigned rights in his own name and a stay of action on the insolvency of the seller should not affect the purchaser’s ability to collect income from the receivables.

If the seller is appointed as servicer for the receivables, the stay of action may prevent the purchaser from taking action to enforce the servicing contract and any proceeds held by the servicer other than in a binding trust arrangement may be deemed to be the property of the servicer, not the purchaser.

If the receivables have been sold by equitable assignment and notice has not been given to an obligor, such obligor may continue to pay the seller. Typically, such proceeds will be subject to a trust in favour of the purchaser. If such a trust has not been imposed on the collections, the purchaser will be an unsecured creditor with respect to such collections.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Assuming the receivables have been sold by legal assignment or perfected equitable assignment, an insolvency official appointed over the seller would not be able to prohibit the purchaser’s exercise of its rights, unless there had been fraud or another breach of duty or applicable law (such as the antecedent transaction regime described in question 6.3).

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in England & Wales for (a) transactions between unrelated parties and (b) transactions between related parties?

The insolvency official would need a court order to reverse an antecedent transaction, except for a disposition of property made after a winding-up petition has been presented (assuming a winding-up order is subsequently made). Such dispositions are void and any receivables purportedly transferred during that period would remain property of the seller.

Otherwise, the court may set aside a transaction made at an undervalue in the two years ending with the commencement of the administration or liquidation if the company was at that time, or as a result of the transaction became, unable to pay its debts as they fell due. There is a defence if the court is satisfied that the company entered into the transaction in good faith with reasonable grounds for believing that it would benefit the company. If a transaction at an undervalue is done with the purpose of putting assets beyond the reach of creditors, there is no requirement to prove contemporaneous insolvency and no time limit for bringing court proceedings.

A transaction which puts a creditor or guarantor of the seller into a better position (in a winding-up) than it would otherwise have been in had that transaction not occurred can be set aside by the court if such preference is made: (i) in the two years ending with the onset of insolvency (in the case of a preference to a person “connected” with the company); or (ii) in the six months prior to insolvency (in the case of any other preference). It is necessary to show that a preference was made with a desire to prefer the creditor or guarantor.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

The equitable remedy of substantive consolidation, which permits the court to treat the assets and liabilities of one entity as though they were those of another, is not recognised by the English courts. Only in circumstances where the assets and liabilities of two companies were indistinguishably amalgamated together, and where to do so would be in the interests of both companies’ creditors, might the court sanction an arrangement reached by the insolvency official and those creditors.

The separate legal personality of a company will only be ignored in very limited circumstances. Examples include fraud, illegality, where a company is formed to evade contractual obligations or defeat creditors’ claims or where an agency or nominee relationship is found to exist.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in England & Wales, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) sales of receivables that only come into existence after the commencement of such proceedings?

Where the receivables purchase agreement provides that no further action is required by the seller for the receivables (including receivables arising in the future) to be transferred, the agreement will generally continue to be effective to transfer the receivables even after the initiation of insolvency proceedings. However, either party could exercise a contractual right to terminate.

Further, in certain circumstances, a liquidator might be able to disclaim (and thereby terminate) an ongoing receivables purchase agreement if it were an “unprofitable contract”. Where the agreement requires further action from the seller, the insolvency official may choose not to take that action and, in that situation, the purchaser’s remedy is likely to be limited to an unsecured claim in any insolvency proceedings.
7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in England & Wales establishing a legal framework for securitisation transactions? If so, what are the basics?

Other than certain tax laws (see question 9.2 in relation to special purpose entities which are “securitisation companies” and their treatment for tax purposes), there are no laws specifically providing for securitisation transactions.

7.2 Securitisation Entities. Does England & Wales have laws specifically providing for the establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no laws specifically providing for the establishment of special purpose entities for securitisation (although see question 9.2 in relation to special purpose entities which are “securitisation companies” and their treatment for tax purposes).

7.3 Non-Recourse Clause. Will a court in England & Wales give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Provisions limiting the recourse of a creditor to the net proceeds of disposal or enforcement of specified assets owned by the obligor or its available funds are likely to be valid under English law.

7.4 Non-Petition Clause. Will a court in England & Wales give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Non-petition clauses are likely to be valid (whether governed by English law or the law of another country), although there is little authority in English law. The most effective method for enforcing such a clause would be injunctive relief which, as an equitable remedy, is at the discretion of the court. A court would have to consider whether such a clause was contrary to public policy as an attempt to oust the jurisdiction of the court or the insolvency laws of the UK. It is possible that an English court would deal with a winding-up petition even if it were presented in breach of a non-petition clause. A party may have statutory or constitutional rights to take legal action against the purchaser or such other person which are not possible to be contractually disallowed.

7.5 Priority of Payments “Waterfall”. Will a court in England & Wales give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

In respect of English law governed priorities of payments, as a general matter, the courts of England and Wales will seek to give effect to contractual provisions that sophisticated commercial parties have agreed, except where to do so is contrary to applicable law.

A recent English Supreme Court decision in Belmont Park Investments Pty Limited v BNY Corporate Trustee Services Ltd and Lehman Brothers Special Financing Inc. [2011] considered whether a contractual provision subordinating a party’s rights to payment on the occurrence of an insolvency event (termed a “flip clause”) was contrary to applicable English law, specifically the “anti-deprivation” and the “pari passu” rules (two sub-sets of a general principle that parties should not contract out of insolvency legislation). The judgment (in which the payment priorities were upheld notwithstanding the fact that the subordination provision was triggered by insolvency of the creditor) put particular emphasis, in deciding whether to give effect to the relevant provisions, on the importance of party autonomy and the desire of the courts to give effect to agreed contractual terms, as well as consideration of whether the relevant subordination provisions were commercially justifiable and entered into in good faith or whether they evidenced an intention to evade insolvency laws.

By contrast, the U.S. Bankruptcy Court has held in parallel proceedings that the English law governed “flip clause” in question was unenforceable as a violation of the U.S. Bankruptcy Code, resulting in competing decisions in the UK and the US and in uncertainty as to whether an adverse foreign judgment in respect of the enforceability of a priority of payments “waterfall” would be recognised and given effect by the English courts in the context of a cross-border insolvency case. Where the priority of payments is governed by a law other than the laws of England and Wales and the English courts have cause to consider its efficacy under that foreign law, the analysis as to whether such a clause would be upheld will be the same as that discussed in questions 3.4 and 3.5, namely that the English courts would apply the foreign governing law to determine whether the priority of payments was effective.

7.6 Independent Director. Will a court in England & Wales give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

A restriction or limitation on the ability of the directors to bring insolvency proceedings contained in the articles of association of a company or in a contract entered into by a company may be invalid as a matter of public policy or incompatible with certain statutory duties of the directors.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in England & Wales, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in England & Wales? Does the answer to the preceding question change if the purchaser does business with other sellers in England & Wales?

A purchaser of consumer receivables requires a licence under the CCA. A purchaser of residential mortgage loans who assumes a servicing and collection role with respect to such mortgage loans...
will require authorisation from the FSA (and, following the transfer of responsibility to the FCA, from the FCA). The purchaser may also be obliged to register under the Data Protection Act 1998 (“DPA”). It makes no difference whether or not the purchaser does business with other sellers in England and Wales.

### 8.2 Servicing

Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The seller is likely to need: (i) a licence from the OFT (and, following the transfer of responsibility to the FCA, from the FCA) under the CCA, since debt collection is a business that is specified as requiring a licence; and (ii) registration under the DPA. Where the seller continues to act as servicer with respect to residential mortgage loans it will be required to be authorised to perform such a role by the FSA (and, following transfer of responsibility to the FCA, the FCA). Any standby or replacement servicer will require the same licences and authorisations.

### 8.3 Data Protection

Does England & Wales have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The handling and processing of information on living individuals is regulated by the DPA. The DPA applies to personal data, so it affects data on individual living obligors and not enterprises. The DPA specifies that a data controller is any legal person who determines the purposes for which, and the manner in which, any personal data is to be processed, and so may well include a purchaser of receivables serviced by the seller. A data controller in the UK must register (known as notification) with the Information Commissioner’s Office unless limited exemptions apply.

### 8.4 Consumer Protection

If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of England & Wales? Briefly, what is required?

The purchase of receivables would not in itself require the purchaser to be authorised as a bank, financial institution or equivalent. The CCA governs consumer credit loans. A purchaser of such receivables is likely to require a licence under this legislation and will be required to comply with such legislation in its dealings with obligors.

The UTCCR applies to agreements made on or after 1 July 1995. A term is “unfair” if it causes a significant imbalance in the parties’ rights and obligations under the contract to the detriment of the consumer. Such an unfair term will not binding on the consumer.

The Unfair Contracts Terms Act 1977 restricts the limitation of liability by a party. Liability for death or personal injury caused by negligence cannot be limited and any clauses that limit liability for other damage caused by negligence must satisfy a reasonableness test.

Mortgage contracts are regulated by the Financial Services and Markets Act 2000 (“FSMA”). Entering into a regulated mortgage contract, arranging or administering it or advising on it is a regulated activity, requiring authorisation from the FSA (and, following the transfer of responsibility to the FCA, from the FCA) under FSMA. Second mortgages and buy-to-let mortgages are currently excluded from “regulated mortgages” but may require a licence from the OFT (and, following the transfer of responsibility to the FCA, from the FCA) under the CCA. Mortgage lenders authorised under FSMA are required to comply with the FSA’s Mortgages: Conduct of Business handbook.

### 8.5 Currency Restrictions

Does England & Wales have laws restricting the exchange of the currency of England & Wales for other currencies or the making of payments in the currency of England & Wales to persons outside the country?

No, subject to any restrictions imposed by United Nations sanctions.

### 9 Taxation

#### 9.1 Withholding Taxes

Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in England & Wales? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

The withholding tax treatment of UK receivables depends not only on their nature but on the nature of the recipient to whom they are paid. Very broadly, payments of interest with a UK source may be paid without withholding to a purchaser which is either resident in the UK or carries on business in the UK through a permanent establishment. Payments of interest to a non-UK resident purchaser may often be subject to withholding subject to any available treaty relief pursuant to a double taxation convention. Generally, the use of relief under a double taxation convention where there are pools of assets that run to more than a very few obligors is administratively challenging. Accordingly loan receivables are typically securitised through the use of a UK resident purchasing company. Generally trade receivables payments and lease rental payments are not subject to UK withholding unless they provide for the payment of interest, in which case the interest element will be subject to withholding in the same way as interest on loan relationships.

#### 9.2 Seller Tax Accounting

Does England & Wales require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The tax treatment of a company within the charge to UK corporation tax would be expected, at least as a starting point, to follow its accounting treatment. For a company purchasing receivables, in many cases the rules imposed by the appropriate accounting regime would be expected to result in the creation of accounting profits, and accordingly taxable profits, which do not reflect the actual cash position of the company in question.

For accounting periods commencing on or after 1 January 2007, the Taxation of Securitisation Companies Regulations are in force. These regulations apply to companies which are “securitisation companies” (as defined in the regulations) and permit such securitisation companies to be subject to tax treatment reflecting the cash position of its securitisation arrangements such that it is taxed only on the cash profit retained within the company after the
payment of its transaction disbursements according to the transaction waterfall. As such, balanced tax treatment can be achieved and the regime has been seen as providing effective relief from the complex or anomalous tax rules which could otherwise apply to UK incorporated special purpose vehicles.

### 9.3 Stamp Duty, etc. Does England & Wales impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty exists in the UK and is chargeable on documents in certain circumstances. Transactions effected without the use of a document may also be subject to UK Stamp Duty Reserve Tax (“SDRT”) levied on transfers of certain types of securities whether by document or otherwise. Generally transfers of loans (which are not convertible and have no “equity” type characteristics such as profit related interest), trade and lease receivables should not be subject to UK stamp duty or SDRT.

### 9.4 Value Added Taxes. Does England & Wales impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

UK value added tax (“VAT”) is chargeable on supplies of goods and services which take place in the UK and which are made by “taxable persons” in the course or furtherance of a business. The standard rate of VAT is currently 20 per cent., although certain supplies (including the supply of certain financial services) are exempt from VAT.

In *MBNA Europe Bank Ltd v HMRC* [2006] it was decided by the UK High Court that the transfer of credit card receivables by an originator in a securitisation was not a supply for VAT purposes. However, that decision may not apply to all such transfers. To the extent that the decision does not apply, a transfer of financial receivables would generally be treated as an exempt supply for VAT purposes.

Generally, fees payable for collection agent services are not exempt from VAT and will usually give rise to VAT at the standard rate, to the extent they are treated as taking place in the UK.

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

As described above, the transfer of financial receivables would usually either constitute an exempt supply for VAT purposes, or fall outside the scope of VAT altogether. However, a seller might incur VAT on a supply of assets which does not fall within any of the exemptions: for example, property or trading assets on a true sale securitisation. If so, the seller would generally be liable to account for such VAT to H.M. Revenue & Customs (“HMRC”).

Broadly, HMRC would not be able to require the purchaser to account for VAT unless the purchaser was a member of the same group as the seller for VAT purposes. Although there are limited exceptions to this general position, it is unlikely that such exceptions would apply in a securitisation context.

Where charged, stamp duty and SDRT are generally payable by the purchaser.

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in England & Wales, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in England & Wales?

Generally the purchase of receivables will not give rise to tax liabilities for a purchaser conducting no other business in the UK, and the appointment of a servicer by the purchaser which carries out normal administrative activities on its behalf should not result in tax liabilities for the purchaser. The question of enforcement is more complex and the particular circumstances would need to be considered carefully.
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Rupert is a partner in the Finance practice of Weil, Gotshal & Manges’ London office with long-standing expertise in securitisation, structured finance, and derivatives. He has experience structuring and leading securitisation deals across a diverse range of asset classes (including trade receivables, credit-card receivables, auto-loans and leases and residential and commercial mortgage loans), encompassing a wide range of structures (including CDO/CLOs, RMBS, CMBS, ABCP conduits, covered bonds and whole business securitisations) and has advised a number of financial and structuring institutions, originators, arrangers, underwriters, trustees and credit enhancers in complex cross-border financing transactions.

Rupert has recently led a number of high-profile matters, including advising a large rental car company on the restructuring and refinancing of its European and Australian rental car fleet securitisations, a large investment bank on a residential mortgage backed securitisation, and one of the world’s largest portfolio managers in relation to a number of existing CDO structures.

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Jacky is head of Weil’s London securitisation and derivatives practice. She has been practising since the mid-eighties when the UK securitisation market was conceived. She has represented both banks and corporate clients on the securitisation of a wide range of asset types in some of the most innovative deals in the market, including ports revenues, residential mortgages, commercial real estate, trade receivables, credit cards, computer/equipment leases, auto-loans, HP receivables and music royalties as well as football ticket and stadium financing. Jacky also has extensive experience in CLO/CDOs, SIVs, ABCP conduits and covered bonds. Legal 500 UK 2012 notes her “wide experience” and that she is “instinctive and insightful, with a no-nonsense approach”, whilst Chambers UK 2013 states that she is “identified by sources as an impressive presence in the field” and has “led the team on a number of high-value and significant transactions”.

Weil’s London structured finance team has been at the forefront of developments in the securitisation and derivatives industry since the establishment of the market in the UK. Over the course of the last year the team has acted on a number of innovative and highly complex securitisation structures (especially in the auto sector) as well as being involved in a large percentage of the new issuance credit card and RMBS transactions to come to market. The team is very active in workstreams related to portfolio trades, distressed investments and restructurings and is considered a leading firm in structuring and documenting CDOs, most recently advising a number of collateral managers and arrangers on the development of European CLO 2.0.

Chambers UK has described the Weil securitisation team as “particularly sought after by clients with UK/US cross-border requirements due to its standout securitisation practices in both jurisdictions”, whilst Legal 500 UK notes that Weil “ticks all the boxes” and is “a definite “go-to” firm with a deep understanding of complex legal and commercial considerations”.

Weil is also one of the only English law firms able to offer access to full service, best-in-class US advice, particularly with regard to specialist areas which impact on new structured finance products being issued and placed in both Europe and the US such as the Capital Requirements Directive, Dodd-Frank, ERISA, FATCA, the Investment Company Act and the Securities Act.
Chapter 16

France

Freshfields Bruckhaus Deringer LLP

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

As a general principle of French law, it is not necessary that the seller and the debtor enter into a formal receivables contract to evidence the sale of goods or services. Therefore, invoices, a historic relationship or any other type of exchange of consent between the seller and the debtor, including by oral agreement, is sufficient to evidence a valid debt obligation.

Notwithstanding the foregoing, the enforceability of the debt obligation of the debtor to the seller is a question of evidence. Under French law, rules of evidence are different depending on the status of the parties and of their relationship.

In summary, evidence of a relationship between commercial parties (i.e. business entities) can be brought by any means. In this respect, invoices or durable business relationships can be regarded as perfectly relevant presumptions of the existence of a contract and therefore of a perfected debt obligation. Between non-commercial parties (i.e. individuals), a written document is necessary to prove the existence of a contract of an amount greater than EUR 1,500.

Finally, if the relationship is entered into between a commercial party and a non-commercial party, the non-commercial party shall have the right to produce evidence of a contract and therefore of a perfected debt obligation by any means, whereas the commercial party may only use the rules of the French Civil Code.

1.2 Consumer Protections. Do France’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Under the French Monetary and Financial Code, a loan granted to a consumer shall not carry an interest rate higher than a specified interest rate (taux d’usure). If the interest rate does exceed such a limit, the bank, having granted the loan, is liable to a penalty of up to two years’ imprisonment or a fine of up to EUR 45,000. However, such a limit does not apply to corporate loans or loans granted to professionals under certain conditions.

As regards interest on late payments, the French Civil Code provides a statutory right to interest on late payment at a minimum interest rate fixed by governmental decree on an annual basis.

A loan granted to a consumer involves certain risks for the lenders, in particular under the provisions of the French Consumer Code. Pursuant to those provisions (procédures de surendettement et de rétablissement personnel), a consumer may request and obtain, from a competent court, a moratorium and/or reduction of its debt and related interest. Moreover, under certain circumstances and conditions, the consumer having borrowed money from a credit institution may obtain the outright cancellation of its entire debts owed to such credit institution.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

French law authorises the sale of receivables to a debtor which is a public body, including the government or a government agency. A sale of receivables to a public entity is not subject to specific principles. However, it is worth noting that the provisions relating to the sale of receivables shall be combined with the specific rules applicable to such public entities.

As regards the validity of a sale of receivables itself, it must be notified to the public accountant (comptable public) of the public entity to which the receivable contract refers, and must be accompanied with the single original (exemplaire unique) of the receivable contract, where such a contract is a public procurement.

Furthermore, the French Daily Law expressly refers to public bodies. Under the French Daily Law, the debtor may officially accept the sale of its debt to a third party. Such an acceptance creates a direct relationship between the debtor and the purchaser and must be duly authorised by the deliberative assembly where the debtor is a public body. In the specific context of public-private partnership agreements, the French Monetary and Financial Code provides that such an agreement may stipulate that certain receivables relating to the investment costs of a project are irrevocable once the public debtor has stated that such investments have been made. As a consequence, after the transfer of such receivables to the purchaser, it is prohibited for the debtor to set off the fraction of receivable which relates to the investment costs against any other debt.

It is a long-standing principle that enforcement procedures provided by the French Code of Civil Procedure cannot be implemented against any public entity. Therefore, the enforcement of a sale of
receivables against any public debtors will be subject to specific administrative proceedings (the Purchaser shall ask Administrative Courts to order an injunction, a periodic penalty payment or a fine).

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in France that will determine the governing law of the contract?

France has ratified the Rome Convention, dated 19 June 1980 on the law applicable to contractual obligations (the Rome Convention), which has been implemented in Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (the Rome I Regulation). According to the Rome I Regulation, when the parties do not specify a choice of law, the receivables contract shall be governed by the law of the country with which it is “most closely connected”. Except in the case of certain consumer contracts, it is presumed that the receivables contract is “most closely connected” with the country where the party effecting the performance which is characteristic of the contract has, at the time the contract is concluded, its central administration.

However, if the receivables contract is entered into in the course of that party’s trade or profession, that country is deemed to be the country in which the principal place of business is situated or, where under the terms of the receivables contract the performance is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated.

2.2 Base Case. If the seller and the obligor are both resident in France, and the transactions giving rise to the receivables and the payment of the receivables take place in France, and the seller and the obligor choose the law of France to govern the receivables contract, is there any reason why a court in France would not give effect to their choice of law?

The Rome I Regulation applies, subject to certain exceptions, to commercial or civil contractual obligations in any situation involving a choice between the laws of different countries, to the extent such countries are Member States of the EEA and are subject to the Rome I Regulation. In relation to the base case above, there would be no conflict of laws in the absence of relevant elements of foreign law. Under the provisions of the French Civil Code, the French law chosen by the seller and the debtors in the receivables contracts will become the mandatory law applying to their relations and such choice will be recognised as a valid choice of law by a French court.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in France but the obligor is not, or if the obligor is resident in France but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in France give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

According to the Rome I Regulation, a contract shall be governed by the law chosen by the parties. Thus, the seller and the debtor are free to choose a law other than French law to govern the receivable contract and the receivables. However this is with the proviso that, where all the other elements relevant to the situation at the time of the choice are connected with France only, such choice of law will not prejudice the application of mandatory rules (ordre public) in France.

Assuming that the debtor is not resident in France, the Rome I Regulation would apply to the potential conflict of laws between the law of the country where the debtor is situated and French law, being the law of the country where the seller is situated and the law governing the receivables contract. According to the Rome I Regulation, the seller and the debtor are free to choose French law to govern the receivable contract. Therefore, the choice of French law to govern the receivables contract will be recognised as a valid choice of law by a French court.

Assuming the seller is not resident in France, the Rome I Regulation would apply in the same terms as described in the above paragraph. Therefore, the choice of French law to govern the receivables contract will be recognised as a valid choice of law by a French court.


3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does France’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., France’s laws or foreign laws)?

French law does not require the sale of receivables to be governed by the same law governing the receivables. Pursuant to article 14 of the Rome I Regulation, the law applicable to the sale of receivables can be freely chosen by the seller and the purchaser of the receivables. However, article 14 provides that the law governing the receivables will determine a certain number of important elements such as: the possibility to assign the receivable, the relationship between the assignor and the debtor, the requirements for the assignment to be enforceable, and the characteristics of a satisfactory payment by the debtor.

3.2 Example 1: If (a) the seller and the obligor are located in France, (b) the receivable is governed by the law of France, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of France to govern the receivables purchase agreement, and (e) the sale complies with the requirements of France, will a court in France recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

A French court will recognise such a sale as effective against the seller, the obligor and other third parties. This, however, assumes that the purchaser is duly authorised to acquire receivables in France (see question 8.1) and that the law applicable to it would not conflict French law. The insolvency administrator is not normally considered as being a third party. It may have some grounds to invalidate an assignment of
receivables in certain circumstances (see question 6.3) but it is the continuation of the seller and, therefore, it is bound by the assignment to the same extent as the seller.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside France will a court in France recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Assuming that the Rome I Regulation is applicable, such assignment would be valid between the seller and the purchaser. However, should the requirement for the sale being enforceable against the obligor under the law of the purchaser’s country and under the law governing the receivable differ, such assignment might not be enforceable against the said obligor. In such example, with regards to the enforceability against third parties not being dealt with by the Rome I Regulation, depending on the countries involved, the situation will be unclear and potentially difficult to resolve. Note that the same assumptions as that referred to in question 3.2 will apply.

4 Asset Sales

4.1 Sale Methods Generally. In France what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Firstly, several conditions must be complied with in respect of the receivables that are intended to be sold by a seller to a purchaser:
(a) the receivables must exist now or in the future;
(b) the receivables must belong to the seller; and
(c) the receivables must be identified and individualised or be capable of being identified and individualised.

Secondly, the status of the purchaser determines the method of sale and the conditions for the sale of the receivables. In this respect, the sale of the receivables must take the form of:
(i) an assignment under the common regime of articles 1689 et seq. of the French Civil Code. The sale is valid between the seller and the purchaser but enforceable against third parties, subject to either the debtors being notified of the sale by a court bailiff, this method of assignment is not often used in the context of securitisation transactions;

(ii) an assignment by way of subrogation pursuant to articles 1249 et seq. of the French Civil Code. Under this method, a third party (the subrogé) pays the initial creditor (the subrogéant) and takes over the initial creditor’s rights against the debtor. The subrogation must be express and must occur at the time of the payment. As from the date of the subrogation, which shall coincide with the delivery of a formal receipt by the initial creditor to the third party (quitance subrogative), the transfer of the initial creditor’s rights against the debtor to the third party shall be effective and enforceable against the debtor without any further formalities. Assuming that the debtor is identified, there are no restrictions in respect of the type of receivables that can be assigned pursuant to the relevant provisions of the French Civil Code or in respect of the status of the purchaser. Given the costs related thereto (around EUR 250 per debtor if a notification is served by court bailiff), this method of assignment is not often used in the context of securitisation transactions;

Assuming that the Rome I Regulation is applicable, such

3.4 Example 3: If (a) the seller is located in France but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in France recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with France’s own sale requirements?

The answer to this question is similar to the answer to question 3.3.

3.5 Example 4: If (a) the obligor is located in France but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in France recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with France’s own sale requirements?

The answer to this question is mainly dealt with by the laws of the relevant country. Should this country be France, the answer to this question is similar to the answer to question 3.3.

3.6 Example 5: If (a) the seller is located in France (irrespective of the obligor’s location), (b) the receivable is governed by the law of France, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in France recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in France and any third party creditor or insolvency administrator of any such obligor)?

Assuming that the Rome I Regulation is applicable, such
performed by way of a single transfer document (acte de cession) exchanged between the seller and the purchaser. The assignment is effective between the parties and enforceable against third parties as from the date affixed by the purchaser on such transfer document without any further formalities. The provisions of the French Monetary and Financial Code have been amended in connection with the Daily Law to secure the sale of future receivables and to develop the sale of receivables in the context of international financing transactions. Despite these recent evolutions, there are still some restrictions as to the type of receivables that can be sold under this method and as to the status of the purchaser. The receivables must arise from a “professional” relationship between the seller and the debtor, and the purchaser must be a credit institution duly licensed in France or an EU-passported credit institution;

(iv) an assignment under the French Securitisation Law pursuant to articles L. 214-42-1 to L. 214-49-14 of the French Monetary and Financial Code. The assignment of the receivables is performed by way of a single transfer document (bordereau) exchanged between the seller and the purchaser. The assignment is effective between the parties and enforceable against third parties as from the date affixed on such transfer document without any further formalities. As for the method of assignment referred to in (iii) above, the provisions of the French Monetary and Financial Code allow the sale of future receivables and the sale of receivables in the context of international securitisation transactions. There are no restrictions as to the type of receivables that can be sold under this method. However, the purchaser must be a French fonds commun de titrisation or FCT, which is an ownership entity without legal personality jointly created by a management company and a custodian. There are many advantages in using this method, including the fact that all related security interests in connection with the purchased receivables are automatically transferred to the FCT without any further formalities, and that the FCT is the only French entity qualifying as a bankruptcy-remote vehicle for rating purposes. Alternatively, the purchaser may be set up under the form of a securitisation company (société de titrisation ou SDT). In this case, the SDT is a commercial company benefiting from the same rules as for a FCT but being subject to a different tax treatment. From experience, an FCT or an SDT is the ideal tool for international securitisation transactions; or

(v) in the case of mortgage loan receivables or receivables on public entities, it should be noted that another method of assignment is provided by articles L. 515-13 et seq. or in case of mortgage loans receivables only, articles L. 515-34 et seq. of the French Monetary and Financial Code. Basically, the conditions and procedures of the assignment are the same as the assignment under the French Daily Law or the French Securitisation Law. However, the Purchaser must be a mortgage company (société de crédit foncier (SCF) or a société de financement de l’habitat (SFH)), which are French financial institutions licensed by the French banking authorities with a limited purpose and structured as bankruptcy-remote entities.

The terminology varies; transfer, sale or assignment are frequently used. From a legal perspective, these are equal.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In order for the sale of receivables to be perfected against third parties, including any later purchaser, the formalities required under the various methods of assignment described in question 4.1 must be complied with. In this respect, the only method of assignment that will require the performance of formalities is the assignment under the general regime of the French Civil Code (i.e. debtors being notified by way of a court bailiff or acceptance of the assignment by the debtors in a deed executed before a public notary).

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Generally speaking, the requirements for the sale and perfection of mortgage loans, consumer loans, promissory notes or debt securities are the following:

(i) promissory notes are transferred by way of endorsement for the benefit of a credit institution; the endorsement transfers the underlying debt to the new holder of such promissory notes;

(ii) marketable debt securities are transferred by way of a transfer order (ordre de mouvement); and

(iii) mortgage loans and consumer loans are transferred in accordance with question 4.1 without the debtor’s consent depending on the method of assignment, and the transfer of the mortgage securing the loans must be registered in the name of the purchaser (except under certain circumstances if the mortgage loans are materialised by specific instruments such as copie exécutoire à ordre).

However, if the sale of the instruments referred to in (iii) above is performed under the provisions of the French Daily Law, the French SCF Law, the French SFH Law or the French Securitisation Law to a credit institution, a SCF, a SFH, a FCT or a SDT, then there are no formalities required in order to transfer the mortgage or other security interests securing the loans.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Whether or not the notification and/or the consent of the debtors is required for the sale to be enforceable against the debtors will depend on the method of the assignment. Under the common regime of the French Civil Code, the sale will be enforceable against the debtors upon a notification being served on them by a court bailiff. Under the French Daily Law or the French Securitisation Law, the sale will be enforceable against the debtors from the date of the sale without any requirement to notify them. In all situations, notification of the assignment to the debtor freezes the right of set off, (if any) of the debtor against the purchaser.

Under French law, in the absence of any provision of the receivables contract expressly prohibiting assignment, the receivables may be freely assigned even without the consent of the debtors, except in respect of the receivables for which French law prohibits the assignment (e.g. receivables relating to alimony).
In addition, the French Commercial Code (article L. 442-6-II-c) provides that any clause of the receivables contract prohibiting the assignment to any third party of the receivables arising from such contract is null and void if such receivables contract is entered into between commercial parties (which exclude receivables contracts entered with consumers).

However, the parties may still contractually limit the assignability of the receivables arising from the receivables contract, for instance by stating that a party will only be allowed to assign the said receivables after having obtained the consent of the other party as to the identity of the assignee.

Apart from the French Daily Law which provides for a specific notification form, the form of notice is not regulated. In all cases, it must be in writing and detailed enough to make clear which receivables have been sold, especially in relation to future receivables. It is generally agreed that the notification of the debtor after the opening of insolvency proceedings against the seller is ineffective if the assignment took the form of the common regime of articles 1689 et seq. of the French Civil Code. When other legal means of assignment (see question 4.1) are used, notification of the debtors can validly be made after the bankruptcy of the seller.

The French Commercial Code (article L. 442-6-II-c) provides that any clause of the receivables contract prohibiting the assignment to any third party of the receivables arising from such contract is null and void if such receivables contract is entered into between commercial parties (which exclude receivables contract entered with consumers). However, the parties may still contractually limit the assignability of the receivables arising from the receivables contract, for instance, by stating that a party will only be allowed to assign the said receivables after having obtained the consent of the other party as to the identity of the assignee. Such provisions are valid but will not be enforceable against the purchaser if it cannot be proven that the latter was aware of the existence of such a restriction.

If (i) the receivables contract is entered into between the seller and a non-commercial party (i.e. customer) or if the receivables contract contains provisions limiting the assignability of the receivables, for instance by stating that a party will only be allowed to assign the said receivables after having obtained the consent of the other party as to the identity of the assignee, and (ii) the purchaser is aware, as at the date it purchased the receivables, of the existing restrictions as to the assignability of the receivables, it might, pursuant to the provisions of the French Civil Code and according to certain French court decisions, be liable for any damage caused to the debtors for having knowingly contributed to the violation of the provisions agreed between the seller and debtors.

Moreover, in such case, the fact of having assigned the receivables without prior consent of the debtors would constitute a breach of contract by the seller. Such contractual breach could give rise to a claim for damages of the debtors against the seller pursuant to the provisions of the French Civil Code. The debtors having a claim against the seller, together with any consequent set off right, may cause the debtors to be or become non-eligible for the assignment.
the completion of the relevant formalities. Upon such formalities (e.g., execution of the transfer document under the French Daily law, the French SCF, the French SFH or the French Securitisation Law), the receivables cease to belong to the seller and are legally transferred to the purchaser. The fact that the seller retains certain risks (credit, interest rate, dilutions, etc.) and may, to a certain extent, (i) control the collections received in its capacity as servicer on behalf of the purchaser, and (ii) have a right to repurchase some of the receivables, has no impact on the perfection of the sale.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

French securitisation transactions are generally structured to provide a commitment from the seller to assign over a certain period of time (revolving period) all or part of the receivables it owns. Such commitment is enforceable against the seller until its insolvency. Upon insolvency of the seller, the insolvency official will have the option either to continue or to terminate such commitment depending on the circumstances. The option of the insolvency official is, however, subject to a formal procedure set out by the French Commercial Code.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The French Securitisation Law specifically provides that the sale of the receivables that come into existence after the date of the sale contract is not affected by the commencement of insolvency proceedings against the seller. According to the French Securitisation Law, the sale is perfected on the date of execution of the transfer document irrespective of the date on which the receivables come into existence (date de naissance), the date on which they become due (date d’échéance) or the date on which they become due and payable (date d’exigibilité), including upon an insolvency proceeding of the seller. The French Securitisation Law has been amended a number of times over the years, in particular, in order to ease the assignment of future receivables and to ensure enforceability, even in relation to future receivables which are sold before, but which come into existence after, bankruptcy of the seller. Thus, the law includes crystal clear provisions to that effect and no specific legal structuring is necessary.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Assuming that the sale of receivables is performed under the French Daily law, the French Securitisation Law, the French SCF Law or the French SFH Law, all related security and ancillary rights will be automatically and without formality (de plein droit) transferred to the purchaser, including in respect of mortgages or other registered security interest. Such transfer will be enforceable as from the date of the sale of the receivables.

5 Security Issues

5.1 Back-up Security. Is it customary in France to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary in France to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security. To our knowledge, subject to “covered bond” type structures, no securitisation transaction implemented in France has used such mechanism to secure the risk that a sale of receivables is deemed by a court not to have been perfected.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of France, and for such security interest to be perfected?

See the answer to question 5.1.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in France to grant and perfect a security interest in purchased receivables governed by the laws of France and the related security?

The French Civil Code provides for a simple procedure to pledge receivables. Such pledge must take the form of a written agreement which identifies the pledged receivables (or which includes the means of identification of the receivables in case of future receivables). Such pledge is valid between the pledger and the pledgee and enforceable against third parties upon signing. It is enforceable against the debtors only upon notification.

The so-called “financial guarantee regime”, resulting from the European Directive on financial collateral, provides for an even more simplified regime which resists bankruptcy of the pledgor but which is only available to financial institutions (which include, for the purpose of this specific regime, French securitisation vehicles).

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of France, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in France or must additional steps be taken in France?

It is generally agreed that a pledge over French assets should be governed by French law. Accordingly, the situation described in this question is to be avoided.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under French law, depending on the type of assets and the legal status of the pledgor and the pledgee, additional or specific formalities might be required on a case-by-case basis.
5.6 Trusts. Does France recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

France has not yet ratified the 1985 international convention relating to the law applicable to trust and their recognition. Accordingly, trusts are generally not recognised under French law, bearing in mind that the situation evolves slowly; in particular, trusts have been expressly mentioned in recent tax laws and a court decision known as the "Belvédère" case recently recognised the capacity of a trust to represent creditors in the context of a parallel debt. In addition, a similar concept has been recently introduced into the French Civil Code. The fiducie is a mechanism which allows a party (constituant) to isolate assets into a special-purpose fund (the fiducie) which is managed by a fiduciary (fiduciaire) to the benefit of the constituant or a third party beneficiary. The fiducie is an agreement. This mechanism is generally not used in connection with securitisation transactions. A fiducie is either set up for assets management purposes or as a security.

The French Securitisation Law has introduced a mechanism to secure the collections received by the seller in connection with the sold receivables. Pursuant to articles L. 214-46-1 and D. 214-103 of the French Monetary and Financial Code, specially dedicated bank accounts are set up in the books of the collection account banks of the seller to receive the collections in respect of the sold receivables and whereby the seller agrees to specially dedicate the collection accounts to the FCT or the SDT. Consequently, the management company will have the right, subject to the documentation of the transaction, to use the amounts credited into such account, as from the date of such agreement. Creditors of the seller will not be able to claim any of the sums collected into this account, under any circumstances including the opening of insolvency proceedings against the seller.

5.7 Bank Accounts. Does France recognise escrow accounts? Can security be taken over a bank account located in France? If so, what is the typical method? Would courts in France recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in France?

Under French law, a security interest may be taken over a bank account. Pursuant to articles 2358 et seq. of the French Civil Code, the seller may grant a security interest on the balance of a bank account (nantissement de compte bancaire) in accordance with the principles applicable to pledges over receivables (nantissement de créances).

The French Monetary and Financial Code also provides for specific forms of pledge over bank accounts known as garanties financières which provide, in certain circumstances, a better protection in case of bankruptcy of the debtor.

The law applicable to charges (sûretés réelles) under French law is, as a matter of principle, the law of location (lex rei sitae) of the asset (either movable or immovable). Similarly, financial guarantees under Directive 2002/47/CE are governed by the law of the Member State in which the financial instruments account is located. Therefore, in case a French bank account is subject to a security interest, the law of such pledge shall be French law, according to the lex rei sitae and by analogy to the provisions on financial guarantees. French courts are generally reluctant to recognise foreign security interests over assets located in France. They set up a series of requirements based on the principle that charges (sûretés réelles) are enumerated to a limited extent under French law (numerus clausus). Hence, the foreign security interest shall correspond to a type of security interest recognised in France and its validity and enforceability requirements shall be similar to those requested under French law.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

In case of a security over a bank account governed by articles 2358 et seq. of the French Civil Code, the scope of the pledge is the credit balance of the bank account on the date the security is enforced. As from the enforcement of the security over the bank account, such account will be blocked and the secured party will be able to control the cash flowing into the relevant account until the release of the pledge over the bank account i.e. until full repayment.

In the context of garanties financières, the beneficiary will be entitled, subject to the terms of the agreement and the way the garantie financière is structured to control all cash flowing to the relevant account as from enforcement and until the secured obligations are repaid in full.

In addition and although this is not considered as a security as such under French law, it must be reminded that, as seen in the answer to question 5.6, the French Securitisation Law provides for specially dedicated bank accounts that are set up in the books of the collection bank and that will allow the management company to control the cash flowing into the collection account, subject to the terms of the agreement.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

In the case of the French Civil Code regime (as described above), the owner of the bank account may have access to the funds standing to the credit of the bank account subject to the pledge, without affecting the security.

In the context of garanties financières, the right of the guarantor to use the money will depend on the type of financial guarantee chosen by the parties. The most preferred route i.e. remittance of cash by the guarantor to the credit of a bank account owned by the beneficiary does not allow the guarantor to use the collateralised amount of cash, since the guarantor is not the owner of the bank account on which the sums are standing.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will France’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insololvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

The commencement of French insolvency proceedings (i.e. safeguard, reorganisation or liquidation proceedings) against the...
seller after the sale of receivables should not prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the receivables, provided that the sale is performed under the French Daily Law, the French SCF Law, the French SFH Law or the French Securitisation Law to a credit institution, a SCF, a SFH, a FCT, or a SDT. From an insolvency law point of view, the sale is valid and enforceable against third parties (including an insolvency official) as from the date of the sale document, and qualifies as a true sale by virtue of law.

In respect of the sale of future receivables (i.e. receivables that arise after the seller becomes subject to an insolvency proceeding). The sale of such receivables by way of a Daily, SCF, SFH, FCT or SDT sale document (acte de cession) should not be affected by the commencement of French insolvency proceedings against the seller as such principle is clearly stated in the law. However, recent court decisions may be seen as challenging this principle, drawing a distinction between receivables which arise from a milestone agreement (contrat à execution successive) or another type of agreement, outright assignment or assignment by way of security and, possibly, notified debtors and other debtors.

### 6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

The insolvency official could not prohibit exercise of rights by the purchaser of the receivables by means of injunction, stay order or other action (but see question 6.1).

### 6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in France for (a) transactions between unrelated parties and (b) transactions between related parties?

In the context of reorganisation or liquidation proceedings (but not safeguard proceedings), a sale of receivables may be challenged by the receiver during a so-called “suspect” period (période suspecte) of up to 18 months prior to the opening of insolvency proceedings if the insolvency official can establish that the sale was made for inadequate value, or if the purchaser was aware of the seller’s insolvency at the time of the purchase.

### 6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Generally, the insolvency official of the seller cannot request the court to order consolidation of the assets and liabilities of the purchaser with those of the seller or its affiliates unless the court finds that there is abnormal commingling of assets between the purchaser and the seller (confusion de patrimoines) or the purchaser is considered to be a sham or a mere fiction (fictivité). In these circumstances, the insolvency proceedings would be extended to the purchaser and would affect its assets, in that the assets of the seller and that of the purchaser would be consolidated.

### 6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in France, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

See question 6.1.

## 7 Special Rules

### 7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in France establishing a legal framework for securitisation transactions? If so, what are the basics?


See the basics in question 7.2.

### 7.2 Securitisation Entities. Does France have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The French Securitisation Law created the fonds communs de titrisation (literally, a ‘common pool of securitisation’, although a better translation would be ‘mutual debt fund’). The FCT is a co-ownership vehicle whose sole purpose is the acquisition of debt receivables. The FCT does not have separate legal personality. It may consist of several ring-fenced ‘compartments’.

The FCT must be constituted jointly by a management company and a custodian. The management company is either an investment management company governed by articles L. 532-9 et seq. of the French Monetary and Financial Code or a management company of funds communs de créances (common pool of receivables) governed by article L. 214-48 in the version before Ordonnance n°2008-556 dated 13 June 2008. The custodian is a credit institution incorporated in the European Economic Area or any institution approved by the French government. The management company and the custodian play an important role in the creation and the life of the FCT, the former as manager of its business and the latter as custodian of the FCT’s assets and as supervisor of the management company.

The French legal provisions on securitisation provides that the FCT is entitled to acquire all types of debts, including existing or future receivables, non-performing receivables or any type of debt instrument governed by French law or any foreign law. The law also provides for the possibility of multiple issues by the FCT of units or any type of debt instruments, including bonds, governed by French law or by any foreign law. Finally, the FCT is entitled to enter into synthetic transactions either as a protection buyer or protection provider, and is the only French entity qualifying as a bankruptcy-remote vehicle for rating purposes. From past experience, it seems that the use of a FCT is the ideal tool for international securitisation transactions (see question 4.1).
FCTs may also be used in order to securitise insurance risks. As far as tax is concerned, the FCT is tax-transparent. Securitisation vehicles can also be set-up under the form of a SDT. In this case, the SDT is a commercial company benefiting from the same rules as for a FCT but being subject to a different tax treatment.

### 7.3 Non-Recourse Clause. Will a court in France give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

The question as to whether contractual limitations on the droit de gage général (commonly referred to as “limited recourse clause”) are valid has given rise to differing doctrinal views and is the subject of very little jurisprudence. However, it is now generally admitted that a court will give effect to a limited recourse clause provided that (i) the limited recourse clause has been freely and knowingly agreed to by the creditor for the benefit of its debtors (and has not been imposed on the creditor by the debtors), and (ii) is the fair consideration for the obligations set out in the agreement such as those pursuant to which the debtors agree to do or not to do certain specific things or to allocate to the creditor certain cash flows in accordance with a specific priority of payment.

### 7.4 Non-Petition Clause. Will a court in France give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The validity of a non-petition provision has been highly discussed under French law as such provision is part of other standard provisions contained in the legal documentation of securitisation transactions. However, it is generally admitted under French law that a court will not give effect to such provision.

### 7.5 Priority of Payments “Waterfall”. Will a court in France give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

The French Securitisation Law (article L. 214-43 of the French Monetary and Financial Code) states that the constitutive documents of the securitisation vehicle may provide for a subordination of the rights of certain creditors to the rights of other creditors. The allocation rules of the cash received by the securitisation vehicle are binding upon the unitholders, the shareholders (as the case may be), the holders of debt instruments issued by the securitisation vehicle and any creditor that have agreed to such allocation rules and subordination rights. The French judge will therefore have to give effect to these contractual provisions, deriving from the French Securitisation Law. In the case of foreign law governed documentation, the judge will give effect to foreign law governed provisions, subject to the French public policy rules. (See the answer to question 2.3.)

### 7.6 Independent Director. Will a court in France give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Under French law, organisational documents and/or any other contract may prohibit directors to take certain specified actions without the vote or consultation of another director appointed as independent director. However, depending on the legal form of the company (e.g. société par actions simplifiée) and the title of the person acting on behalf of the company, such provisions may not be enforceable against third parties.

### 8 Regulatory Issues

#### 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in France, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in France? Does the answer to the preceding question change if the purchaser does business with other sellers in France?

Any purchaser other than a FCT or SDT must be licensed in France as a credit institution in order to purchase non-matured receivables on a regular basis for consideration. The fact that the purchaser does business in France with other sellers has no impact on the above requirement which relates to the nature of the contemplated operation (i.e. the purchase of non-matured receivables).

#### 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Servicing and collection activities for the benefit of third parties are also regulated activities in France unless the purchaser is a credit institution, a FCT, or a SDT. In practice, when the seller acts as servicer or collection agent of its own receivables for the account of the purchaser, it is not required to comply with French regulation applying to servicing activities. It should be noted that under the French Securitisation Law the transfer of servicing from the seller to any third party must be notified to the debtors.

#### 8.3 Data Protection. Does France have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

French law regulates the transfer of personal data. The aim of such regulation is to protect the rights of individuals, including consumer debtors. However, it does not apply to debtors that are incorporated as enterprises.

The applicable regulation is known as the “Loi Informatique et Liberté” dated 6 January 1978 (as amended). Under such regulation, the transférer of personal data must, except under certain circumstances, inform each individual of any data transfer...
that directly identifies such individual or could allow his identification. The application of such regulation is placed under the control of the Commission Nationale Informatique et Liberté (CNIL).

In practice, there have been a number of solutions implemented in order to accommodate the application of the relevant regulation within the context of securitisation transactions, such as transferring only partial information or codified information.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of France? Briefly, what is required?

The purchaser will not be required to comply with any additional consumer protection law except as stated in question 8.2. Consumer protection law, such as enforcement rules against consumer debtors, will continue to apply to the extent that the seller acts as servicer.

8.5 Currency Restrictions. Does France have laws restricting the exchange of France’s currency for other currencies or the making of payments in France’s currency to persons outside the country?

Under French law, it is a general principle that international payments are free of any administrative or governmental control. However, recent anti-money laundering rules impose an obligation on credit institutions to declare any suspect payments or transactions.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in France? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Since 1 March 2010, payments of interest and other income by debtors established or domiciled in France are not subject to any French withholding tax, unless they are made outside France in a non-cooperative State or territory (NCST) within the meaning of Article 238-0 A of the French Tax Code (FTC), in which case they are subject to the 75 per cent withholding tax set out under FTC, §125 A III, unless a tax treaty reduces or eliminates such withholding tax.

A jurisdiction is statutorily defined as a NCST if, cumulatively: (i) it is not a Member State of the European Union; (ii) it is under scrutiny by the OECD Global Forum on Transparency and Exchange of Information; and (iii) it has not entered into with France, or with twelve other jurisdictions, a treaty providing for exchange of information in relation to tax matters.

The latest list of NCST was published by the French government on 4 April 2012 and includes the following countries: Brunei, Botswana, Guatemala, Marshall Islands, Montserrat, Nauru, Niue, and the Philippines.

The list is updated every year by the French government, with a view to including jurisdictions which would qualify as NCSTs pursuant to the criteria referred to above or which would, in practice, not be sufficiently cooperative with the French tax authorities (FTA). In any case, if a State or territory is added to the list on year N, the new rules will only have effect on payments to this State or territory on 1 January of year N+1.

Jurisdictions which agree to exchange information in relation to tax matters with France, or which are removed from the aforementioned OECD list of jurisdictions under scrutiny, would be removed from the NTSC list with immediate effect.

Interest payments on debt instruments issued or entered into prior to 1 March 2010 or which are to be consolidated (assimilables) with debt instruments issued before 1 March 2010 continue to benefit from the exemption (where available) provided by FTC, §131 quater. (In particular, interest paid in respect of obligations or titres de créances négociables, or other debt securities considered by the FTA as falling into similar categories, are exempt from the withholding tax set forth in FTC, §125 A III under FTC, §131 quater.)

The 75 per cent withholding tax does not apply if the debtor can prove that the “main purpose and effect” of the transactions from which the payments originate is not to “locate” income in a NCST. Pursuant to the official doctrine of the FTA (BOI-RPPM-RCM-30-10-20-50-20120912, ## 70 and 80), an issue of debt securities benefits from such exception without their issuer having to provide any proof of the purpose and effects of such issue if such debt instruments are:

(i) offered by means of a public offer within the meaning of article L. 411-1 of the French Monetary and Financial Code or pursuant to an equivalent offer in a State other than a NCST (i.e. any offer requiring the registration or submission of an offer document by or with a foreign securities market authority);

(ii) admitted to trading on a French or foreign regulated market or multilateral securities trading system, provided that such market or system is not located in a NCST and the operation of such market is carried out by a market operator, an investment services provider, or a similar foreign entity, provided further that such market operator, investment services provider or entity is not located in a NCST; or

(iii) admitted, at the time of their issue, to the clearing operations of a central depositary or of a securities clearing, delivery and payments systems operator within the meaning of article L. 561-2 of the French Monetary and Financial Code, or of one or more similar foreign depositaries or operators, provided that such depositary or operator is not located in a NCST.

9.2 Seller Tax Accounting. Does France require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No, it does not.

9.3 Stamp Duty, etc. Does France impose stamp duty or other documentary taxes on sales of receivables?

There is no transfer tax, stamp duty or other documentary tax on the assignment of receivables (unless the assignment is voluntarily registered with the FTA, in which case a nominal stamp duty of EUR 125 per registered document is payable).

9.4 Value Added Taxes. Does France impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The assignment of receivables should not attract VAT in France.
The servicing fee paid to a French seller qualifies for the VAT finance exemption, except as regards debt recovery services which are subject to French VAT.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

No, it will not.

9.6 Doing Business. Assuming that the purchaser conducts no other business in France, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in France?

The purchaser would have a French corporate income tax liability if the place of effective management of the purchaser were in France or the purchaser had a permanent establishment (PE) in France. In relation to securitisations, the question is whether the fact that the collection of receivables is carried out by the French seller might result in the French seller being deemed to act as a dependent agent of the purchaser and thus in creating a French PE of the purchaser. In order to reduce that risk, the seller should have limited authority to bind the purchaser, and the servicing agreement should be carefully drafted.

Avocat à la Cour, Hervé Touraine joined Freshfields Bruckhaus Deringer in 1995 and became partner in 1998. His practice focuses on structured finance, securitisation, capital markets and banking. In the context of securitisation transactions, Hervé has been working closely since the introduction of securitisation in France, with various arrangers, originators, rating agencies, monoline insurers and regulatory authorities. Hervé has advised on numerous domestic and international transactions (including many firsts in France and Europe). Hervé has an extensive experience in structuring and managing cross-border securitisations involving numerous countries. He is an active player in drafting French securitisation and structured finance legislation and regulations in France.

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Freshfields Bruckhaus Deringer LLP is widely regarded as having one of the best international securitisation practices available. Through its international network it handles a significant proportion of the largest and most complex transactions, including those with a large cross-border element, in both civil law and common law jurisdictions.

We award great importance to the quality of the advice we give to our clients. We strive to understand their legal, economic and commercial environment in order to anticipate their needs and assist in their strategic decision making process. We deliver creative, pragmatic advice adapted to our clients’ circumstances.

The flexibility and resourcefulness of our lawyers enables our Practice to accompany our clients in their most varied projects, especially during the financial crisis where innovation and simplicity are key to success.

The Finance Group in Paris currently consists of 25 lawyers, including 5 Partners and 4 Counsels. Their biographies are available on our website.
Chapter 17

Germany

Cleary Gottlieb Steen & Hamilton LLP

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Under German law, it is not necessary for the creation of an enforceable debt obligation of the obligor that a sale of goods or the provision of services be evidenced by a formal receivables contract. It is sufficient if the parties agree orally on the sale of goods or the provision of services, or if the respective agreement is deemed to exist due to the facts and circumstances, including as a result of the behaviour of the parties. Of course, in such cases it may, as a practical matter, be difficult to prove the scope of the sale or the services concerned, as well as the consideration payable therefor. An invoice alone, if not backed by a formal or informal receivables contract, would not be sufficient to create an enforceable debt obligation.

1.2 Consumer Protections. Do Germany’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

There are no German laws that would specifically regulate permissible rates of interest on consumer credit, loans or other kinds of receivables. Under a general provision in the German Civil Code, however, a receivables contract that provides for a usurious rate of interest can be void. According to German case law, as a rule of thumb, the applicable limit in this regard is twice the market rate or, in periods of particularly high market rates, around 12 per cent per annum above the market rate. The application of the referenced code provision will, however, always be driven by the facts and circumstances.

If the obligor is in arrears (Verzug) in discharging the receivable of the seller, German statutory law provides that the receivable bears interest at the base interest rate (Basiszinssatz) published by Deutsche Bundesbank plus 5 per cent per annum or, if the obligor is not a consumer, 8 per cent per annum. An obligor would generally be in arrears if it does not make payment when due and: (i) the payment was due on a specified date; (ii) the obligor has, after the payment became due, received a payment reminder (Mahnung); or (iii) the obligor has received an invoice and does not make payment within thirty days of the due date and the receipt of such invoice.

For loans to consumers (and transactions, such as hire-purchase transactions, that are closely linked to consumer loans), German law provides for special rules that are designed to protect borrower consumers. In order to be enforceable in accordance with their terms, any such loan agreements have to contain certain information on the loan (which should help the consumer to assess his or her future payment obligations) and need to be in writing. In addition, the lender is obligated to explain the features of the loan. In the case of real estate loans, the lender also has to inform the consumer borrower of any possibility to assign the loan without the borrower’s consent. The borrower is entitled to rescind the loan agreement within two weeks from its execution. Furthermore, the lender is required to notify the borrower in advance of an interest reset and approaching maturity.

Borrowers may terminate loans as of the end of the period for which a fixed rate of interest was agreed if such period expires prior to the maturity of the loan and no new rate of interest is agreed. In any case, borrowers may terminate loans with six months’ prior notice as of the end of the tenth year following the disbursement of the loan. Loans with a floating rate of interest may be terminated with three months’ prior notice.

Other consumer protection laws become relevant in respect of contracts entered into at the place of abode of the obligor and contracts comprising standard business terms.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Where the government or its agencies enter into receivables contracts for general commercial purposes, no special rules apply to the sale, assignment or collection of such receivables, except that any such assignment is valid, generally, even where there is a contractual prohibition on assignments (see question 4.4 below). Special assignment restrictions and notice requirements apply to tax reimbursement and similar claims. Tax authorities can enforce assessed taxes without the help of the courts. In securitisation transactions, due to enforceability concerns, public law receivables against government agencies are frequently considered ineligible.
2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Germany that will determine the governing law of the contract?

In principle, under Regulation (EC) 593/2008 on the law applicable to contractual obligations (Rome I) (the “Regulation”), in the absence of any (explicit or implicit) choice of law by the parties to the receivables contract, the laws of the country to which such receivables contract has the closest link govern the receivables contract. In this context, the Regulation contains several presumptions which help identify what country that is. If the specific presumptions do not apply, the laws of the country apply where the contractual party that has to perform the characteristic obligations under the contract is located. The presumptions and this general rule do not apply if a contract is manifestly more closely connected with another country, in which case such country’s laws apply. Special rules apply to particular categories of contracts, namely consumer contracts, shipping contracts, insurance contracts and employment contracts.

2.2 Base Case. If the seller and the obligor are both resident in Germany, and the transactions giving rise to the receivables and the payment of the receivables take place in Germany, and the seller and the obligor choose the law of Germany to govern the receivables contract, is there any reason why a court in Germany would not give effect to their choice of law?

No. A German court would give effect to the parties’ choice of law.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Germany but the obligor is not, or if the obligor is resident in Germany but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Germany give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

As a general rule, the Regulation permits the parties to a receivables contract to choose the law governing that contract. Such a choice of law can be express or implied. A choice of law provision can also be added or modified after the original contract was entered into. However, where a receivables contract is exclusively connected with one or more EU Member States and the parties have chosen the law of a non-EU Member State, German courts would apply such provisions of EU law (as implemented in Germany) which cannot be derogated from by agreement, irrespective of the choice of law. In addition, German courts may give effect to overriding mandatory provisions of the law of the country where the contractual obligations have to be performed. Finally, any contractual choice of law is subject to the German ordre public.


Yes, the CISG has been ratified and has been in effect in Germany since 1 January 1991.

3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Germany’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Germany’s laws or foreign laws)?

As regards the relationship between the seller and the purchaser, German law (i.e., the Regulation) does not require the sale of receivables to be governed by the law governing the receivables. Accordingly, the seller and the purchaser may choose the law that shall apply to the sale, subject to the rules described in question 2.3 above. However, as regards (i) the receivables’ assignability, (ii) the relationship between the purchaser and the obligor, and (iii) the question whether the assignment can be invoked against the obligor, the law governing the receivables applies. Furthermore, the Regulation is silent, and there is no other express rule in German law, as to what law applies to the enforceability of the sale vis-à-vis third parties. While we would expect German courts in light of past practice to apply the law governing the receivables in this respect, some commentators have taken the view that the laws of the seller’s jurisdiction should govern the question whether a sale of receivables is effective vis-à-vis third parties.

3.2 Example 1: If (a) the seller and the obligor are located in Germany, (b) the receivable is governed by the law of Germany, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Germany to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Germany, will a court in Germany recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, because, under the rules described in question 3.1 above, German law would apply to the question of whether the sale is effective against the seller, the obligor and other third parties.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Germany, will a court in Germany recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

As described in question 3.1 above, generally, neither the obligor’s nor the purchaser’s location is relevant for the question what law applies to the effectiveness of sales of receivables. Accordingly, a German court would recognise the sale as being effective without regard to any requirements of the obligor’s country or the purchaser’s country (or both).
3.4 Example 3: If (a) the seller is located in Germany but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Germany recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Germany’s own sale requirements?

As described in question 3.1 above, a German court would generally apply the law selected by the parties as regards the relationship between the seller and the purchaser (subject to the rules described in question 2.3 above). Accordingly, a German court would recognise the sale as being effective as regards the relationship between the purchaser and the seller because the sale complies with the requirements of the law chosen by the parties to govern the receivables purchase contract. Furthermore, a German court would view the sale as being effective against the obligor because the sale complies with the laws governing the receivable. If a German court also applied, in light of past practice, the law governing the receivable to the question whether the sale is effective against third parties, there would be no need to comply with Germany’s own sale requirements. If, however, the court applied the law of the seller’s jurisdiction (see question 3.1 above) in this respect, it would consider the sale as being effective against the obligor only if the parties also complied with such requirements.

3.5 Example 4: If (a) the obligor is located in Germany but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Germany recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Germany’s own sale requirements?

Yes, because, under the rules described in question 3.1 above, the law of the seller’s country would apply to the question of whether the sale is effective against the seller, the obligor and other third parties.

3.6 Example 5: If (a) the seller is located in Germany (irrespective of the seller’s location), (b) the receivable is governed by the law of Germany, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Germany recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), any obligor located in Germany and any third party creditor or insolvency administrator of any such obligor)

As described in question 3.1 above, a German court would recognise the sale as being effective against the seller because a German court would apply (subject to the rules described in question 2.3 above) the law chosen by the parties with regard to the relationship between purchaser and seller and the sale complies with the requirements of such law, provided that the receivable is assignable pursuant to the law governing it (i.e., German law). As regards the relationship between the purchaser and the obligor as well as third parties, a German court would apply German law (which is the law of the seller’s location as well as the law governing the receivable) to the question whether the sale is effective.

4 Asset Sales

4.1 Sale Methods Generally. In Germany what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

Although not legally required, for evidentiary purposes, receivables are generally sold and assigned under written sale and assignment agreements entered into between the seller and the purchaser. The customary terminology for the transfer of a receivable under German law is an “assignment” (Abtretung), while a “sale” (Verkauf) describes the contractual undertaking to assign. However, elsewhere in this chapter, the term “sale”, in line with the definition of such term above, is used to describe a transfer.

4.2 Perfection Generally. What formalities are required generally for perfection of a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Under German law, generally, the only requirement for an effective sale of receivables is the existence of a corresponding assignment agreement between the seller and the purchaser. Giving notice of the assignment to the obligor is not required for the effectiveness of the sale. However, failure to give notice to the obligor results in the obligor retaining certain defences as described in question 4.4 below. Under German law, generally, there is no good faith acquisition of receivables.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In Germany, debt certificates (Schuldscheine) are frequently used instruments that are similar to promissory notes in other jurisdictions. Debt certificates, which evidence loan obligations, are not securities. No additional requirements apply to the assignment of debt certificates, although in practice the purchaser requires the seller to hand these over in connection with an assignment of the related loan. Mortgage loans in Germany can take several forms. Liens on German real property can be granted in the form of an accessory mortgage (Hypothek) or a non-accessory land charge (Grundschuld). Both can be either in certificated or non-certificated form. A mortgage is accessory in that it cannot be transferred without the receivable that it secures, and that it is automatically transferred if such receivable is transferred. The assignment of a loan that is secured by a mortgage requires a written assignment of the loan and: (i) in the case of a certificated mortgage, delivery of the mortgage certificate; or (ii) in the case of a non-certificated mortgage, registration of the transfer with the competent land register. A loan secured by a land charge can be assigned without the land charge, by way of a simple agreement between the seller and the purchaser. If the land charge is to be transferred as well, such transfer has to be by written assignment of the land charge and delivery of the certificate.
or registration of the transfer, as applicable. In addition, according to recent case law the purchaser has to assume the seller’s obligations under the security purpose agreement setting forth the conditions under which the land charge may be enforced. Transferring un-certificated mortgages and land charges (which make up the vast majority of mortgages and land charges in Germany) can, depending upon the values involved, trigger significant costs in connection with the required registration with the land register. In many cases, sellers express an interest in avoiding registration of the transfer in order to avoid having the obligor obtain knowledge of the assignment. For this purpose, the parties frequently agree that the seller shall hold the land charge as trustee for the purchaser. (This is not possible in the case of a mortgage.) However, it is unclear under German law whether such a trust relationship would be recognised in the insolvency of the seller, i.e., whether the purchaser would be entitled to request the seller’s insolvency official to transfer the land charge.

In September 2005, the German Banking Act was amended to provide for, among other things, so-called “refinancing registers” (Refinanzierungsregister) to be maintained by banks in respect of receivables, including mortgages or land charges securing such receivables that such bank or a third party owns but is obligated to transfer to a securitisation vehicle. Effectively, without a perfected sale being effected at the outset of the transaction, such registration provides the purchaser with the same right to segregate the assets concerned from the seller’s insolvency estate (thereby addressing the issues described above) as would apply if a perfected sale had occurred.

In the case of an assignment of consumer loans, the seller must notify the consumer of the assignment and the details of the purchaser without undue delay, unless the seller and the purchaser agree that the seller shall exclusively continue dealing with the consumer obligor. Also, an advance consent of the obligor (in particular a consumer) contained in standard business terms to an assumption of the entire obligations under the security purpose agreement setting forth the conditions under which the land charge may be enforced.

Transfer to a securitisation vehicle. Effectively, without a perfected sale being effected at the outset of the transaction, such registration provides the purchaser with the same right to segregate the assets concerned from the seller’s insolvency estate (thereby addressing the issues described above) as would apply if a perfected sale had occurred.

Additional requirements relating to the sale of debt securities under German law depend upon the type of securities involved. The transfer of bearer securities requires an agreement between the seller and the purchaser to transfer ownership and the delivery of the securities to the purchaser. Registered securities are transferred by way of assignment of the rights that they evidence. Instruments made out to order are transferred by way of agreement between the seller and the purchaser to transfer ownership, endorsement and delivery of the instrument to the purchaser. Where debt securities are certificated in global form and deposited with a clearing system, delivery of the securities is evidenced by way of book-entry.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

In principle, under German law, giving notice to the obligor is not required for an effective sale and assignment of a receivable, unless required by the receivables contract. The purchaser is generally entitled to enforce the receivable directly against the obligor (providing required evidence of the assignment), whether or not the obligor was previously notified of the assignment. However, the obligor may generally invoke against the purchaser all defences that it had against the seller at the time of the sale (see below). If the sold receivable is a consumer loan, the seller generally must notify the consumer of the assignment and the details of the purchaser.

Unless the obligor has been notified or has otherwise obtained knowledge of the assignment, it may validly discharge its obligation by making payment to the seller, and the purchaser is bound by any amendment to the receivables contract agreed by the seller and the obligor. The same applies if the seller and the obligor enter into any other transaction relating to the receivable, such as a waiver of the receivable by the seller or a deferral of payments.

In addition, the obligor continues to be able to discharge its obligation under the assigned receivable by offsetting it against a payable of the seller unless (i) the obligor knew of the assignment when it acquired the payable, or (ii) the payable becomes due only after the obligor has obtained knowledge of the assignment and after the assigned receivable has become due. In other words, even if the obligor has obtained knowledge of the assignment, it may continue to offset the assigned receivable against a payable of the seller if (i) it acquired the payable before it obtained such knowledge, or (ii) the payable has become due before the receivable becomes due.

Accordingly, as described above, notification of the obligor is not required for an effective sale of a receivable under German law, but giving notice of the assignment to the obligor is beneficial in order to cut off certain defences of the obligor.

As a general rule, a receivable that is governed by German law can be freely sold and assigned without the obligor’s consent if the underlying agreement does not contain any prohibition on assignments. A prohibition on assignments would usually be explicit, but can also be implied in a receivables contract. Until 2007, it has been disputed among German courts and commentators whether the assignment of a receivable in violation of German data protection laws or contractual general bank secrecy obligations should result in an implied prohibition on assignments. However, a decision of the German Supreme Court settled the issue in 2007 such that generally neither contractual general bank secrecy obligations nor German data protection laws result in implied prohibitions on assignments. It should be noted that it is not fully clear whether this would be equally applied to an assignment of receivables involving the transfer of data whose confidentiality is protected by German criminal law (e.g., in respect of a doctor’s patient data, in respect of which a 2005 Court of Appeals decision considered an assignment void).

Where a receivables contract contains a prohibition on assignments, the seller can still undertake to assign the receivable, but it cannot effect a valid assignment in rem. The seller is liable for any damages incurred by the obligor in connection with an assignment that failed on this basis.

As an exception to the foregoing rule, a seller can validly assign a receivable (with the exception of loan claims of credit institutions) in spite of a contractual prohibition on assignments where both the seller and the obligor are corporate entities, partnerships or individual merchants and the receivables contract constitutes a commercial transaction, or where the obligor is a government agency. However, it is not fully clear whether any such assignment constitutes a breach of contract that can result in liability for damages or for the payment of any contractual penalty. In any event, in such a case the obligor can still discharge the receivable by...
making a payment to the seller (or by way of set-off), even where the obligor has been notified of the assignment. The resulting risks, which can be eliminated only by obtaining the obligor’s consent, generally lead rating agencies to conclude that the highest rating categories cannot be applied where the effectiveness of the assignment is based upon this exception.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

As described in question 4.4 above, under German law, generally, the obligor need not be notified of the assignment to make the assignment effective, unless required by the receivables contract. However, notification is required to cut off certain defences of the obligor. No specific formal requirements apply to such notification. If a receivables contract requires notification, the notice must comply with the applicable contractual requirements. Furthermore, any such notice that is contractually required must be delivered before insolvency proceedings against the obligor are commenced, because the assignment would not be effective without such notice. In contrast, even where a contractual notice requirement exists, it is possible to deliver the notice after insolvency proceedings against the obligor have commenced. Where a notice of assignment is specifically required under statutory law, the notice must comply with the applicable statutory requirements, e.g., be given in writing or contain certain information. Generally, if more than one receivable or future receivables are assigned, the assignment notice may be given for all receivables concerned.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Germany? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Germany recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

As described in question 4.4 above, parties other than, generally, merchants in respect of commercial transactions, can enter into binding prohibitions on assignments. Prohibitions to sell receivables (i.e., an undertaking not to enter into a receivables purchase agreement) would also be enforceable, but are not common because they do not prevent the assignment from being effective. If a seller sells a receivable in violation of a prohibition to sell or assign the receivable, it would be liable, generally, to the obligor for any financial damages incurred. Such liability for breach of contract is not fully clear in respect of commercial transactions among merchants and receivables against government agencies.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

It is not necessary to specifically identify each of the receivables to be sold in order to provide for an effective sale and assignment of German law-governed receivables. It is sufficient if the receivables are identifiable, e.g., by reference to the initial letters of the obligor names, or if all of the seller’s receivables (or all of its receivables other than receivables owing by one or more specifically identified obligors) are sold.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

A German court would not automatically respect the parties’ denomination of their transaction as a sale, but also take into account the economic characteristics of the transaction. Furthermore, the economic characteristics have no bearing under German law as to whether the sale is being “perfected”. However, such characteristics could be relevant for determining whether the sold receivables no longer form part of the seller’s insolvency estate, or whether the transaction must be re-characterised as a secured loan. Given that there is no case law on point and limited other guidance in published form in this respect, the exact circumstances in which a purported sale must be re-characterised as a secured loan are not fully clear.

The general view in the market is as follows: any true sale of receivables requires an effective assignment of legal ownership as described in question 4.2 above. In connection with any such assignment, the mere retention by the seller of the risk that the receivables exist and are legal, valid, binding and enforceable does not result in the true sale character of the transaction being jeopardised, and neither does the continued servicing of the receivables by the seller. The possible re-characterisation of the transaction rests, in particular, on the seller’s retaining an excessive portion of the credit risk from the receivables sold, including through representations and warranties, repurchase obligations/automatic re-assignments, variable purchase prices, liquidity/credit enhancement provided by or on behalf of the seller, or the acquisition by the seller of a first loss tranche of the securities issued. The seller may retain some portion of the credit risk in line with historical default rates and taking into account enforcement costs.

Where the sale of receivables is re-characterised as a secured loan for insolvency law purposes, upon the opening of a German insolvency proceeding with respect to the seller, the seller’s insolvency official and not the purchaser is entitled to collect the receivables. In addition, the insolvency official is entitled to retain
from the collection proceeds a flat fee (haircut) of, generally, nine per cent for the benefit of the insolvent estate. The amount of this fee may be adjusted where the actual enforcement costs are significantly higher or lower. A four per cent fee applies where the insololvency official permits the purchaser to collect the receivables. Upon a collection by the insolvent official, the collection proceeds (after deduction of these fees) are to be transferred to the purchaser. As a practical matter, secured creditors frequently enter into agreements with insolvent officials providing for higher haircuts.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes. However, as a technical matter, in factoring or securitisation transactions involving continuous or periodic sales and transfers of receivables, the seller and the purchaser generally enter into a framework agreement that governs the terms and conditions for each future sale and transfer of receivables. The actual sale and transfer in respect of individual receivables is then evidenced (in the case of continuous sales) or effected (in the case of periodic sales) on the basis of exchange of data on the transferred receivables by which the latter are identified. However, such arrangements would not prevail in an insolvency of the seller for sales not consummated prior to the insolvency. See also question 6.5.

Under German law, it is possible to sell and assign receivables arising in the future, provided that such receivables are sufficiently identified (or at least identifiable, see question 4.7 above). German law does not require any specific sale structure for the sale of future receivables being valid and enforceable beyond the requirements applicable to receivable sales generally. In principle, the sale of future receivables requires the existence of a corresponding assignment agreement between the seller and the purchaser (see question 4.2 above). The purchaser then obtains ownership of such receivables at the time when they arise, unless at such time other prerequisites of a valid assignment have ceased to exist, in which case the assignment fails. The latter applies, in particular, where an insolvency proceeding has been opened with respect to the seller prior to the receivable coming into existence because in such a case the seller is no longer able to dispose of its assets. It should be noted that, in certain circumstances, it is difficult to determine whether a receivable is in fact a “future” receivable to which these rules apply (such as a claim for future rental payments) or an existing receivable that is not yet due (such as the repayment claim under a loan agreement). See also question 6.5.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Under German law, it is possible to sell and assign receivables arising in the future, provided that such receivables are sufficiently identified (or at least identifiable, see question 4.7 above). German law does not require any specific sale structure for the sale of future receivables being valid and enforceable beyond the requirements applicable to receivable sales generally. In principle, the sale of future receivables requires the existence of a corresponding assignment agreement between the seller and the purchaser (see question 4.2 above). The purchaser then obtains ownership of such receivables at the time when they arise, unless at such time other prerequisites of a valid assignment have ceased to exist, in which case the assignment fails. The latter applies, in particular, where an insolvency proceeding has been opened with respect to the seller prior to the receivable coming into existence because in such a case the seller is no longer able to dispose of its assets. It should be noted that, in certain circumstances, it is difficult to determine whether a receivable is in fact a “future” receivable to which these rules apply (such as a claim for future rental payments) or an existing receivable that is not yet due (such as the repayment claim under a loan agreement). See also question 6.5.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

See question 4.3 above, in respect of transferring collateral of the type of instruments described therein. Related security consisting of receivables assigned by way of security assignment (Sicherungsabtretung) as well as guarantees (Garantien) is transferred by way of assignment, requiring an agreement between the seller and the purchaser to assign the relevant security. Insurance claims are also assigned, usually requiring notification to, and sometimes the prior consent of, the insurer. If the collateral comprises security over inventory and other movable assets in the form of a security transfer (Sicherungsübereignung), the purchaser needs to obtain (indirect) possession of the inventory concerned. If the sold receivable is secured by a pledge (Pfandrecht) or surety (Bürgschaft), no additional arrangements are necessary to transfer such collateral.

See also question 5.3 below.

5 Security Issues

5.1 Back-up Security. Is it customary in Germany to take a "back-up" security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No, this is not customary.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Germany, and for such security interest to be perfected?

This is not applicable in Germany (see question 5.1 above).

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Germany to grant and perfect a security interest in purchased receivables governed by the laws of Germany and the related security?

Under German law, if the purchaser wants to grant security over all of its assets, it must individually charge such assets in accordance with applicable law, i.e., German law does not know the concept of a floating charge over all assets of the chargor. Generally, a German law security interest in a receivable or related security as well as other assets of the purchaser can be granted in the form of a formal pledge or a security assignment. To become effective, a formal pledge of a receivable (including guarantees) requires the execution of a pledge agreement and notification of the obligor. A security assignment, which results in the transfer of legal ownership of the receivables concerned, subject to the assignee’s undertaking to foreclose only upon a default and to re-assign the receivables to the assignor upon the performance in full of the secured obligations, becomes effective on the basis of the same requirements as described above in respect of assignments of receivables generally. Accordingly, a security assignment generally does not require notification of the obligor. (However, failure to notify results in the obligor retaining set-off rights and other defences as described in question 4.4 above.) Due to the fact that assignors frequently seek to avoid such notification, security assignments are far more common than formal pledges of receivables. Exceptions to this rule apply where the notification of the obligor is not an issue, including in respect of inter-company receivables and bank accounts. There have been a few German
securitisation transactions that have relied on pledges of receivables, but this continues to be a very uncommon form of security in Germany.

Security over inventory and other movable assets is usually granted in the form of a security transfer because a formal pledge would require the pledgee to obtain actual possession of the assets, whereas indirect possession is sufficient for a security transfer. For security over the types of instruments described in question 4.3 please see question 4.3. The additional requirements described therein also apply to the grant of security over such types of instruments. See also question 4.11 above.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Germany, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Germany or must additional steps be taken in Germany?

The conflict of laws rules described in question 3.1 above in respect of assignments of receivables generally also apply to the grant of security interests, whether in the form of a formal pledge or a security assignment. Accordingly, as between the purchaser and the secured party, the security interest would be considered valid and perfected if the requirements of the law chosen to govern the security agreement were met, provided that the receivables are assignable pursuant to the law governing them (i.e., German law). Whether the security interest is valid and perfected with respect to the obligor depends on the law governing the receivables. Where the receivables are governed by the laws of Germany, the purchaser and the secured party need to take such additional steps, if any, as German law might require to validly grant and perfect the security interest vis-à-vis the obligor. The same applies in respect of the question whether the security is valid and perfected vis-à-vis third parties if a German court in that respect applied the law governing the receivables (and not the laws of the purchaser’s country, see question 3.1 above).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under German law, security over insurance policies, promissory notes, mortgage loans, consumer loans and marketable debt securities can also be granted in the form of a formal pledge or by way of security assignment. (In the case of debt securities, the most common form of security is a formal pledge.) As a general matter, the additional requirements described in question 4.3 above also apply to the grant of security over these types of instruments. Security over insurance policies generally requires notification of the insurance company to be effective.

5.6 Trusts. Does Germany recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

German law concepts of fiduciary relationships or trusts are in many respects different from Anglo-American trust concepts. In particular, solely agreeing on a trust over an asset such as collections of receivables or bank accounts would not suffice to separate such collections or bank accounts from the seller’s estate and would not be upheld in an insolvency of the seller. Neither would an economic or equitable interest of the purchaser in an asset, as such, be sufficient to so segregate assets from the estate of the seller. (Under certain circumstances, a trust over non-German assets might be recognised by German courts and have the effect of segregating the trust assets, but this depends on the law governing the trust, the effects of such law, and whether such effects can be reconciled with German law concepts.)

In order to segregate collections from the estate of the seller, several structure alternatives exist. The safest way is to notify the obligors of the assignment and collect the receivables in an account of the purchaser. Alternatively, because the parties sometimes do not wish to notify the obligors of the assignment or if the notification is too cumbersome, the seller could continue to collect the receivables in one or more accounts set up specifically for such purpose. Such accounts could be either pledged to the purchaser or established as escrow accounts which are, generally, recognised under German law. (Please note that the preference periods described in question 6.3 below might apply to the collections or disbursements thereof to the purchaser, unless such periods had already lapsed with respect to the acquisition of the collected receivable.)

Where it is not feasible to collect the receivables in a special account (whether pledged or in the form of an escrow account), the seller could pledge its “general” collection account to the purchaser, but this would in most cases not offer sufficient protection to the purchaser in respect of collections received prior to the opening of an insolvency proceeding. Also, such pledge might conflict with prior-ranking standard pledges of the account bank (which are customary in Germany). In such case, the purchaser would have to rely on the (automatic) termination of the seller’s entitlement to collect the receivable upon certain triggers and a swift redirection of the collections to minimise losses, usually coupled with frequent sweeps from the general account.

5.7 Bank Accounts. Does Germany recognise escrow accounts? Can security be taken over a bank account located in Germany? If so, what is the typical method? Would courts in Germany recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Germany?

As regards the recognition of escrow accounts, see question 5.6 above. Security over bank accounts located in Germany customarily takes the form of a formal pledge (see question 5.3). Taking foreign law security over bank accounts located in Germany is not customary, and there is a substantial risk that German courts would not recognise such security, in particular if the requirements of a formal pledge (including notification of the account bank) were not met.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Assuming that the secured party enforces its German law security in the form of a pledge over a bank account at a time when insolvency proceedings have been commenced against the owner of the account, the secured party would not control any cash flowing into the bank account from enforcement forward. Rather, the secured party would be able, generally, to realise, in accordance...
with German law, its pledge over any amounts standing to the credit of the account at the time the insolvency proceedings were commenced (subject in particular to any rights of the insolvency official to challenge the security). If the owner of the account is not insolvent at the time of enforcement, the security arrangements can provide for the “control” of the secured party over all cash flowing into the bank account until repayment of the secured party in full, subject to corresponding arrangements with the account bank. See also question 5.6 above.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, the parties can agree that the owner of the account shall have access to the funds in the account prior to enforcement, which would not affect the security. Of course, any funds withdrawn from the account would no longer be available as security.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Germany’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Before rendering a decision on whether or not to open a formal insolvency proceeding and to appoint an insolvency official, German insolvency courts frequently appoint a so-called “preliminary insolvency official” for the time period (generally one to three months – a so-called “preliminary insolvency proceeding”) during which they assess whether the insolvent company’s assets cover the costs of the insolvency proceeding. As a general matter, there is no stay of action on the purchaser’s right to collect, transfer and otherwise exercise ownership rights over receivables that were sold to it, neither before nor after the opening of an insolvency proceeding. Amendments to the German Insolvency Code that took effect on 1 March 2012 did not result in any changes in this regard. German insolvency courts, however, may prohibit persons owning assets not belonging to the insolvent estate (such as purchasers of receivables in true sale transactions) or holding security based on a security assignment over receivables (such as purchasers of receivables in true sale transactions) from collecting or otherwise exercising their rights over the receivables during the preliminary insolvency proceeding. After the opening of an insolvency proceeding with respect to the seller, the purchaser would be entitled to collect the receivables only if the transaction constituted a true sale. Where the transaction is re-characterised as a secured loan, the assignment in rem of the receivables is regarded as a security assignment, which results in the insolvency official, rather than the purchaser, being entitled to collect the receivables concerned (and to deduct a haircut from the collection proceeds, all as described in question 4.8 above). See also question 6.2 below.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

As described in question 6.1 above, German insolvency courts may prohibit persons owning assets not belonging to the insolvent estate (such as purchasers of receivables in true sale transactions) or holding security based on a security assignment over receivables from collecting or otherwise exercising their rights over the receivables during the preliminary insolvency proceeding. In addition, insolvency courts have the right to issue an order permitting a preliminary insolvency official to collect receivables that were assigned by way of security.

Upon the opening of an insolvency proceeding with respect to the seller, no injunctions, stay orders or similar court orders may be issued where there was a true sale, and there is no need for any such orders (because the insolvency official in any event has the exclusive right to collect) where the transaction is re-characterised as a secured loan. However, as a practical matter, where the insolvency official seeks to determine whether the transaction constituted a true sale or has to be re-characterised as a secured loan and meanwhile prevent the purchaser from collecting the receivables, the insolvency official will simply notify the obligors accordingly. This generally has the effect that obligors cease making payments.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Germany for (a) transactions between unrelated parties and (b) transactions between related parties?

Upon the opening of an insolvency proceeding in Germany, the insolvency official is entitled to rescind acts of the seller (including assignments of receivables) that prejudice third party creditors, provided that certain additional requirements are met. These requirements are set out in statutory rules. German insolvency courts do not have the same discretion in this respect that insolvency courts have in other jurisdictions. Preference periods range from one month to ten years prior to the filing of the application for the opening of the insolvency proceeding.

In particular, the insolvency official has the right to challenge acts that granted a creditor collateral or satisfaction if the act was performed (i) during the last three months prior to the filing of the application for the opening of an insolvency proceeding, provided that at such time the debtor was unable to pay its debts as they became due and the creditor knew of such inability, or (ii) after such filing, provided that at such time the creditor knew of the debtor’s inability to pay its debts or the filing.

The insolvency official can also challenge acts that granted a creditor collateral or satisfaction to which such creditor was not entitled – or not in such a way or not at such time – if the act was performed (i) during the last month prior to the filing of the application for the opening of an insolvency proceeding or after such filing, (ii) during the second or third month prior to the filing of the application and the debtor was illiquid at such time, or (iii) during the second or third month prior to the filing of the application and the creditor knew at the time such act was performed that such act was detrimental to the debtor’s third party creditors.
Furthermore, the insolvency official has the right to challenge acts performed with the intention – as known to the creditor – to prejudice the debtor’s third-party creditors if the act was performed within ten years prior to the filing of the application for the opening of an insolvency proceeding or after such filing.

Finally, the German Insolvency Code contains a number of presumptions that make it easier for an insolvency official to challenge transactions between the debtor and its related parties. E.g., the insolvency official may challenge any transaction between the debtor and a related party if the transaction was (i) entered into for consideration during the two years preceding the filing of the application to open an insolvency proceeding, (ii) directly detrimental to the debtor’s third-party creditors, and (iii) performed by the debtor with the intention to prejudice the debtor’s third-party creditors, unless the related party can prove that it did not know of such intention.

Where the assignment of receivables constitutes a so-called “cash transaction” (Bargeschäft), the insolvency official is entitled to rescind the transaction only if it can be shown: (i) that the assignment was effected with an intention to prejudice creditors and the purchaser knew of such intention; or (ii) that the purchaser was not entitled to the receivables assigned. An assignment of receivables generally constitutes a “cash transaction” if the seller, at or about the same time as the assignment was effected, received adequate consideration. In this respect, depending on the type of receivables involved, an assignment may qualify as a “cash transaction” even where the purchase price paid reflects some discount from the nominal value of the assigned receivables. A large discount, a significant time lag between assignment and payment of the consideration, or a deferred purchase price arrangement, however, disqualify the transaction as a “cash transaction”.

### 6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

German insolvency law does not contemplate the substantive consolidation of assets and liabilities of sellers and purchasers or their affiliates. Under general corporate law principles, there may be liability under piercing the corporate veil principles, but this does not result in any consolidation of assets and liabilities. In January 2013, the German Federal Ministry of Justice (Bundesjustizministerium) issued an internal draft Bill to Facilitate the Handling of Group Insolvencies (Entwurf eines Gesetzes zur Erleichterung der Bewältigung von Konzerninsolvenzen) which would, if enacted as drafted, introduce special rules relating to the insolvency of group companies. These new rules would provide for increased cooperation among the parties in separate insolvency proceedings in respect of various group companies, but there would continue to be no substantive consolidation of assets and liabilities.

### 6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Germany, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

German insolvency law gives an insolvency official the right to elect whether to perform or reject performance of executory contracts, i.e., contracts that have not been fully performed by at least one party. The application of this general rule affects future sales of receivables as well as mutually unperformed contracts underlying the (existing) receivables sold and the assignment of receivables that have not yet come into existence (i.e., future receivables). Where the insolvency official’s election right does not apply in respect of a contract underlying receivables, the contract concerned continues to bind the insolvency estate and the counterparty, but as explained below this does not always result in the enforceability of the sale and assignment of resulting receivables.

The receivables purchase agreement itself may be subject to the insolvency official’s election right if the agreement has not been fully performed by at least one party, in particular if it addresses future sales. If properly drafted, however, receivables purchase agreements pertaining to term deals are generally not subject to the election right because the seller (by assigning the receivables) has fully performed its relevant obligations. In the case of a receivables purchase agreement in a revolving securitisation transaction which provides for a series of sales under a single master agreement, any election by the insolvency official to reject performance may also pertain to sales that were consummated in the past. To avoid this risk, each sale under the master agreement must be structured as an independent transaction.

In the case of mutually unperformed contracts underlying the receivables sold, where the insolvency official has an election right and elects performance, any future payments by the obligors are due to the insolvency estate, not to the purchaser. Where the insolvency official elects to reject performance, the receivables do not become due at all. Consequently, unless the cash flows required to service the asset-backed securities are otherwise ensured, a successful securitisation generally requires that the insolvency official’s election right does not apply to the underlying receivables contracts. In addition, an assignment of “future receivables” that come into existence after the opening of the insolvency proceeding (as opposed to the assignment of previously existing receivables that become due after the opening of the insolvency proceeding) is not enforceable.

- Upon the insolvency of the seller/lessor, leases and leasing contracts pertaining to movables are not subject to the insolvency official’s election right if the acquisition of the leased objects was financed by a third party and that third party has obtained security in the form of a security transfer of the leased objects. (Legal uncertainty exists in this regard where the lessor is not identical to the owner of the leased objects, which is not uncommon in the German leasing market.) It is a question of the applicable facts and circumstances (i.e., in particular the terms of the applicable lease or leasing contract) whether the receivables under such contracts are, for German insolvency law purposes, “future receivables”. In general, installments due under so-called “financial leasing” contracts are considered not to constitute “future receivables”, but to come into existence upon the conclusion of the leasing agreement and to become due from time to time.

- Leases pertaining to real estate are not subject to the insolvency official’s election right but may be terminated by the insolvency official (subject to statutory notice periods) irrespective of the agreed term of the lease. Furthermore, lease receivables under real estate leases constitute “future receivables” and cannot be validly assigned with effect for the seller’s/lessor’s insolvency estate to the extent that they pertain to the period after the month in which the insolvency proceeding is opened (or, where the opening date is later than the 15th day of a month, the next following month). Nevertheless, any such lease receivables can be (and
customarily are) covered by a mortgage or land charge over the relevant real estate that can be enforced by the mortgagee in the seller’s/lessor’s insolvency.

By contrast, as regards the securitisation of fully disbursed bank loans, that the insolvency official’s election right does not apply, given that the relevant loan agreements no longer constitute executory contracts. This was clarified by a legislative amendment in 2007. Also, receivables becoming payable from time to time under a bank loan do not constitute “future receivables”.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Germany establishing a legal framework for securitisation transactions? If so, what are the basics?

Germany has no laws containing a comprehensive set of rules applicable to securitisation transactions. However, certain typical aspects of securitisations are addressed in special statutes. In particular, Germany has introduced, in the context of transposing directive 2009/111/EC (also called CRD II) into German law, a set of rules applicable to credit institutions (Kreditinstitute) and financial services institutions (Finanzdienstleistungsinstitute) investing in, sponsoring or originating securitisation transactions. Most importantly, such institutions are prohibited from investing in securitisation transactions where the originator does not retain, on an ongoing basis, a net economic interest in the transaction of at least five per cent, which amount will be increased to 10 per cent from 2015 onwards. Moreover, institutions investing in securitisation transactions must have a comprehensive and thorough understanding of the positions (and their underlying assets) they are investing in, and establish formal procedures in order to ensure such understanding and monitor the positions they have invested in. Similarly, restrictions on investments in securitisation transactions by insurance companies and pension funds are expected to be enacted. Although the rules are aimed at institutions, they indirectly affect other originators as well because such originators need to structure their securitisation transactions accordingly (by retention of an economic interest as well as reporting obligations) in order to allow institutions to invest in their securitisation transactions.

7.2 Securitisation Entities. Does Germany have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Germany does not have any such laws. It should be noted that, in the past, no German entities were used as purchaser vehicles in securitisation transactions. This has mainly been due to the trade tax issue described in question 9.6 below. Following the introduction, in 2003, of a trade tax exemption for certain purchaser vehicles in bank loan securitisation transactions, there have been a number of transactions involving German purchaser vehicles, including transactions under the German True Sale Initiative.

7.3 Non-Recourse Clause. Will a court in Germany give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

See question 7.4.

7.4 Non-Petition Clause. Will a court in Germany give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The predominant view is that such non-recourse clauses and non-petition clauses are valid and enforceable under German law, except to the extent that the relevant underlying claim is based upon the purchaser’s wilful misconduct or gross negligence. But see question 7.6 regarding the obligation of the management of certain types of companies organised under German law to file for insolvency upon illiquidity or over-indebtedness.

7.5 Priority of Payments “Waterfall”. Will a court in Germany give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Creditors may validly agree on “waterfall” or “priority of payments” arrangements among themselves or with their debtor, and German courts generally will give effect to such arrangements independent of the governing law, provided that the parties have validly chosen such law in accordance with the rules described in question 2.3 above. Where the debtor is party to such an arrangement, however, the parties cannot validly agree to change the statutory order of priority pursuant to German insolvency law. As an exemption from this rule, a creditor could agree to become deeply subordinated in the insolvency of its debtor. However, this is usually not intended by customary “waterfall” or “priority of payments” arrangements because such an arrangement would benefit all other creditors and not only the creditors party to the “waterfall” arrangements. Rather, in an insolvency of the debtor, the creditors that are party to such arrangements would constitute creditors of the same rank for insolvency law purposes and be obligated to distribute any amounts received among themselves according to the priorities agreed.

7.6 Independent Director. Will a court in Germany give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In the case of German SPEs (which are generally in the form of limited liability companies (GmbH)), such a provision would be generally given effect to. However, the statutory obligation to file for the opening of an insolvency proceeding where the company is either unable to pay its debts as they become due or over-indebted, and the incurrence by management of personal liability for damages and criminal liability upon a breach of such obligation, would remain unaffected by any non-petition clause in the transaction documents or the GmbH’s organisational documents.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Germany, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Germany? Does the answer to the preceding question change if the purchaser does business with other sellers in Germany?

The general view in the market is that, as a securitisation transaction does not involve the transfer of any undrawn commitments, the purchase and ownership of receivables by the purchaser, and its collection and enforcement of receivables owned by itself, do not trigger any licensing requirements in Germany. The German bank regulator has confirmed this view for revolving securitisations in connection with the introduction of a new licensing requirement for factoring services providers.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The collection and enforcement of the sold receivables by the purchaser itself does not trigger any licensing requirements in Germany. However, where the receivables are serviced by a third party on behalf of the purchaser, such party generally must be registered under the German Legal Services Act. An exception from the registration requirement applies where the seller continues servicing the sold receivables that were originated by itself. Consequently, as a practical matter, this registration requirement becomes relevant only in the case of a transfer of the servicing to a replacement servicer. In addition, any servicer must comply with German data protection laws.

8.3 Data Protection. Does Germany have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Germany has data protection laws, the most important of which is the Federal Data Protection Act, that restrict the use and dissemination of data about, or provided by, obligors. This law applies only to personal data relating to individuals (including individuals in their capacity as merchants or employees) and, in the view of some commentators, partnerships that have individuals as partners. The law provides that, where the affected individual has not consented to the transfer of personal data, such transfer is permissible only if the transferor’s interest in transferring the data outweighs the affected individual’s interest in avoiding such transfer. The predominant view is that, in a typically structured securitisation transaction, this analysis generally results in the permissibility of the transfer of data. The argument in favour of this conclusion is even stronger where a securitisation transaction is structured so that it involves a data trustee as referred to in the German bank regulator’s securitisation release described below (which is, however, not always the case where non-bank assets are being sold).

Independently of data protection laws, banks are subject to bank secrecy restrictions vis-à-vis their customers (individuals or other customers). These restrictions are considered to be of a contractual nature. The standard business terms of German banks generally address these expressly, but even where there is no such express provision, German courts consider banks to be bound by an implicit restriction. In 1997, the German bank regulator issued a release on the securitisation of German bank assets, which also addressed bank secrecy requirements. The regulator took the position that bank secrecy is complied with as long as the seller bank continues to service the bank loans sold because no transfer of obligor-related information to the purchaser is required. Where a back-up servicer is appointed, the regulator generally requires it to be a credit institution based within the EU or the European Economic Area. In any event, the regulator considers disclosure of information permissible: (i) to the extent required for an effective assignment, if the purchaser receives obligor-related information in anonymised form, with the complete set of information being deposited with an independent data trustee; and (ii) to the extent that information is “strictly technically required” to be passed on, and passed on in anonymised form, to third parties (such as rating agencies, auditing firms or security trustees) that are also bound by a confidentiality obligation. Although the views expressed by the German bank regulator are not binding upon German courts, they are generally considered to be of persuasive value. The general view in the German market is that bank secrecy is not violated in a securitisation transaction that is structured so as to comply with the requirements set out in the 1997 release. In addition, the German bank regulator stated in a release in 2007 that it will consider, in light of the court decision described in question 4.4, whether the requirements set forth in the 1997 release have to be revised.

Neither data protection nor bank secrecy is an issue where the obligor has approved the transfer of the relevant data. Such approval may be contained in a general consent to a sale and assignment of receivables for refinancing purposes. Some German banks have recently amended their standard business terms to that effect. However, such consent is probably invalid if contained in standard business terms permitting the assumption of the entire loan contract by a purchaser, unless the purchaser is identified in the standard business terms or the obligor is given the right to terminate the loan in case the loan contract is transferred (see question 4.3 above).  

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Germany? Briefly, what is required?

As a general rule, the originator of the receivables (i.e., the seller) is primarily responsible for compliance with German consumer protection laws. Non-compliance may affect the validity of the receivables contracts or give the obligor a rescission right. Consequently, the purchaser needs to review whether the seller has been in compliance with these laws. In addition, it is customary for the seller to give the purchaser corresponding representation and warranties. Consumer protection laws become particularly relevant in respect of loan agreements, receivables contracts entered into at the place of abode of the obligor, and receivables contracts that are based upon the seller’s standard business terms.

The following German consumer protection laws relating to consumer loans should be noted: a lender must notify its consumer obligor three months before an agreed interest rate expires or the loan matures, stating whether it is willing to agree on a new interest rate or to extend the loan. This obligation also applies to a purchaser of the loan, unless the seller and the purchaser agreed that the seller shall exclusively continue dealing with the consumer...
8.5 Currency Restrictions. Does Germany have laws restricting the exchange of Germany's currency for other currencies or the making of payments in Germany's currency to persons outside the country?

Germany has no such laws (with the exception of those implementing United Nations, EU or other international sanctions in respect of transactions with certain countries and persons). Where a German resident receives from, or makes payments to, non-German residents, the German resident must in certain circumstances notify such payments to Deutsche Bundesbank. However, such notification serves for statistical purposes only, and failure to notify does not affect the payment or the underlying obligation.

9 Taxation

9.2 Seller Tax Accounting. Does Germany require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Germany has not adopted any specific accounting policy for tax purposes in the context of a securitisation. German tax law generally follows German GAAP. The concept of economic ownership under German GAAP and German tax law is essentially the same. The answer to the question as to whether the seller or the purchaser has to show the assigned receivables in its tax balance sheet depends on whether the sale of the receivables can be considered a true sale or a secured loan, i.e., whether economic ownership in the receivables has been transferred. Economic ownership of the receivables generally remains with the seller if the seller continues to bear the credit risk associated with the receivables. This is the case, for example, where the amounts retained by the purchaser to cover credit risk (e.g., purchase price discounts) significantly exceed the expectable default rate and are refundable (if the credit risk does not materialise). The treatment under IFRS or US GAAP is not decisive for German tax purposes.

9.3 Stamp Duty, etc. Does Germany impose stamp duty or other documentary taxes on sales of receivables?

Germany does not impose a stamp duty or other documentary taxes on sales of receivables. On 14 February 2013, however, the European Commission published a draft directive for the introduction of a financial transaction tax in eleven EU Member States (including Germany). The sale of securitised receivables may, therefore, become subject to financial transaction tax in the future.

9.4 Value Added Taxes. Does Germany impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Germany generally imposes value added tax at a rate of 19 per cent on sales of goods or services. The sale of receivables is exempt from value added tax (but the seller can generally elect to waive this exemption). We believe that this exemption also applies where the purchaser not only acquires the receivable but assumes the entire contractual relationship with the obligor (but see the Swiss Re decision of the European Court of Justice (ECJ) of 22 October 2009). In general, Germany also imposes value added tax on fees for collection agent services. In consequence of the MKG-Kraftfahrzeuge-Factoring GmbH decision of the ECJ of 26 June 2003 (the “MKG decision”), the German tax authorities consider the purchaser of receivables to be rendering taxable collection services (also referred to as “factoring services”) to the seller when the purchaser assumes the actual collection of the receivable. The value added tax for such factoring services is generally assessed on the difference between the nominal value of the receivables assigned and the purchase price for such receivables, minus the value added tax included in such difference. The German tax administration has applied special rules to determine the assessment basis with respect to distressed receivables. Following the principles established by a preliminary ruling of the ECJ in the matter of GFKL dated 27 October 2011, however, the German Federal Tax Court decided on 26 January 2012 that the purchase of distressed receivables does generally not constitute a service by the purchaser to the seller (notwithstanding that the purchaser collects the receivables) and, consequently, is not subject to value added tax.
The tax authorities have not yet aligned their administrative guidelines accordingly, and it remains to be seen how they will apply the decision by the German Federal Tax Court.

In view of the German tax authorities, no taxable collection services are being rendered by the purchaser where the seller continues to collect the receivables after the sale, as is typically the case in securitisation transactions. In this case, the collection of the receivables by the seller is not treated as a separate service to the purchaser, provided that, in collecting the receivables, the seller acts in its own interest and on the basis of its own, retained right. Even when the seller’s activity is based on a separate agreement, such activity does not give rise to taxable collection services. It is then viewed as a supplementary service to a tax-exempt transaction and therefore the fees for such collection agent services are also exempt from value added tax. The predominant view among market participants is that, due to the aforementioned interpretation, the issues created by the MKG decision have been resolved for typical German securitisation transactions.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

The tax authorities are able to make claims against the purchaser for unpaid value added tax when the seller was required to pay such value added tax on a sale of goods or services that gave rise to the receivables. The tax authorities may only make claims against the purchaser if and to the extent the purchaser collects the receivables.

The purchaser is deemed to have collected the receivables in full if the purchaser grants a second assignment (or pledge) of the receivables to a third person (including a security assignment or pledge of the purchased receivables to a security trustee). This also applies when the purchaser receives no consideration for this second assignment.

Pursuant to guidance issued by the German tax authorities, the receivables are “deemed not to have been collected by the purchaser” (so that no liability arises) if and to the extent the purchaser pays consideration for the receivables to the free disposition of the seller. On this basis, the risk of the purchaser becoming liable for value added tax in a typical securitisation transaction is generally limited to the value added tax contained in the difference between the nominal amount of the receivables sold and the purchase price paid by the seller, e.g., due to discounts and cash reserves.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Germany, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Germany?

In general, the purchase of receivables would not make a purchaser that conducts no other business in Germany liable to tax in Germany. Exceptions may apply if the receivables give rise to income from German sources (as defined in German tax law). In some cases (e.g., interest payments on hybrid debt instruments), the purchaser’s liability to tax in Germany is then satisfied through withholding (see question 9.1 above). In other cases, the purchaser’s (corporate) income tax liability is assessed on the basis of its net income from German sources. For example, interest payments on loans secured by German situs real estate give rise to a tax liability and a filing obligation in Germany under domestic law (see question 9.1 above). In many of its income tax treaties, Germany waives the right to tax interest on loans secured by German situs real estate.

The appointment of the seller as the purchaser’s service and collection agent, or the purchaser’s enforcement of the receivables against the obligors, should not ordinarily make the purchaser liable to tax in Germany. However, the German tax authorities have in the past indicated that they may treat the purchaser as a resident of Germany for tax purposes if the purchaser is an entity that has no substantial presence outside of Germany. In this case, the purchaser may be treated as having its effective place of management in Germany because the seller in its capacity as servicer and collection agent makes the decisions relating to the day-to-day management of the purchaser’s business (in particular, the enforcement of the receivables against the obligors) in Germany. As a result, the purchaser would be subject to German (corporate) income tax and trade tax.

Even where it can be established that a purchaser is effectively managed from outside of Germany, the purchaser may still have a taxable presence in Germany if the tax authorities consider the seller as a dependent agent in Germany due to its collection services for the purchaser. This mainly depends on whether the seller is bound by the instructions of the purchaser. If the purchaser agrees that the seller can continue the collection on its own terms and the purchaser has no possibility to intervene, a point can be made that the seller is not acting as a dependent agent.

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Michael Kern is a senior attorney based in Cleary Gottlieb’s Frankfurt office. Mr. Kern’s practice focuses on insolvency, real estate and banking law. He also frequently advises distressed debt investors in connection with debt collections and loan-to-own strategies. In recent years, Mr. Kern advised Goldman Sachs as a lender in the restructuring of the EUR 3.7 billion Karstadt real estate financing, and the origination and restructuring thereof. Mr. Kern also advised an ad hoc group of buy-side and sell-side market participants on cross-jurisdictional insolvency issues related to customer access to central CDS clearing platforms, which included the participation and support of ISDA, SIFMA, AMG and MFA. He also acted as insolvency counsel to The Clearing Corporation, together with IntercontinentalExchange (ICE) and a consortium of derivatives dealers, in the introduction of ICE Trust US, the first clearing and settlement platform for Credit Default Swaps. Mr. Kern joined Cleary Gottlieb in 2000. He passed the second state examination in the State of Hesse in 1998 and the first state examination at the University of Frankfurt am Main in 1996. Mr. Kern is admitted to practice in the Federal Republic of Germany.
Chapter 18

Greece

KG Law Firm

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) A formal receivables contract is not necessary in order to create an enforceable debt obligation, unless otherwise provided in the law (article 158 of the Greek Civil Code, GCC), e.g. certain debts arising under consumer legislation must be concluded in writing.

(b) An invoice (depending on its terms) may itself represent the contract between the parties or evidence an obligation arising from such contract. An invoice is enforceable without an underlying contract, provided it has been accepted by the obligor.

(c) Where a contract is oral, evidence of the parties’ conduct is admissible for the purposes of ascertaining the terms of the contract. Moreover, a contract may be implied between parties based on the conduct of the parties or continuous dealings between them (e.g. in the context of a frame agreement), where the obligations arising from the implied contract are sufficiently certain/specific to be enforceable. In all cases where an obligation allegedly arises from an oral contract, it is up to the competent court to determine the existence of such obligation and the terms thereof.

1.2 Consumer Protections. Do Greek laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) There are no limits on the interest set on banking loan and credit agreements of any type; however, banking interest rates and compound interest thereon are subject to restrictions, mainly with respect to unilateral changes of interest rates by the banks and frequency of interest capitalisation.

Non-bank interest rates (and default interest rates) of contractual obligations are capped at a rate which is adjusted periodically by reference to the ECB rates. Compound interest is allowed only subject to certain conditions.

(b) Yes. Statutory right to interest on late payments in commercial transactions is provided by presidential decree 166/2003 transposing European Directive 2000/35/EC into Greek law.

(c) Yes. Certain clauses of receivables contracts may be unfair or abusive according to various legislative provisions and/or Greek courts’ rulings.

(d) Greece has transposed European legislation on consumer protection; therefore, a consumer benefits from the protection accorded by such legislation, both general and special.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

In most cases, yes. Products sold and services rendered to state authorities and the public sector in general are governed by (a) the special provisions of European legislation regulating public procurement, as such legislation is transposed into Greek law, and (b) special Greek law provisions which reserve favourable treatment to the Greek state in a series of matters (e.g. prolonged duration of deadlines, prolonged prescription periods, approval and/or authorisations required for the validity of certain contracts concluded with the government, special delivery mechanisms, special requirements for enforcement against the government/government agencies, etc.).

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Greece that will determine the governing law of the contract?

In case both the seller and the obligor are Greek residents, delivery is agreed to take place in Greece and no other foreign elements appear in the receivables contract, Greek law will apply. In case one of the parties is not a Greek resident and/or delivery is agreed to take place outside Greece and/or other foreign elements appear in the receivables contract, the governing law thereto will be determined, in the absence of a specific choice of law, (a) pursuant to EU Regulation 593/2008 of 17 June 2008 on the law applicable to contractual obligations (“Rome I”), in case the contract was entered into on or after 17 December 2009, or (b) pursuant to the Rome Convention on applicable law on contractual obligations dated 19 June 1980 (the Rome Convention), which was transposed...
into Greek law by law 1792/1988 and entered into effect on 1 April 1991, in case the contract was entered into prior to 17 December 2009. For those contracts which fall outside the scope of the Rome Convention or Rome I, the applicable law will be decided pursuant to article 25 GCC, according to which the contract is governed by the law to which the parties have submitted themselves and, in absence thereof, by the law which is appropriate to the contract, after taking into consideration all special circumstances of the case. Specific contracts are regulated by special private international law provisions (such as consumer contracts, guarantees, international sales contracts, contracts of carriage, insurance contracts and individual employment contracts).

2.2 Base Case. If the seller and the obligor are both resident in Greece, and the transactions giving rise to the receivables and the payment of the receivables take place in Greece, and the seller and the obligor choose the law of Greece to govern the receivables contract, is there any reason why a court in Greece would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Greece but the obligor is not, or if the obligor is resident in Greece but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Greece give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Pursuant to the Rome Convention and Rome I, the contracting parties are free to choose the law of their contract (including a foreign law); such choice may be modified only to the extent that it conflicts with overriding Greek mandatory rules or Greek public policy (ordre public) or if there are special protective provisions for certain contracts or for certain types of contracting parties (such as consumers). For those types of contracts not within the scope of the Rome Convention or Rome I, article 25 GCC also gives priority to the lex voluntantis (the foreign law which the parties have chosen) and will modify such choice in case of abuse or violation of Greek mandatory rules or Greek public policy.


Yes, it has been transposed into Greek law by law 2392/1997.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Greek law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Greek laws or foreign laws)?

Greek law does not require that a sales contract be governed by the law governing the underlying receivables, irrespective of which law governs the receivable. However, the in rem transaction resulting from such sale, i.e. the transfer of the receivables, will be governed by the law of the underlying receivable; therefore, formalities for completion of the transfer, such as the announcement of the transfer to third parties or registration thereof (where applicable) in public registries, that are required under the law of the receivable, must be complied with.

3.2 Example 1: If (a) the seller and the obligor are located in Greece, (b) the receivable is governed by the law of Greece, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Greece to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Greece, will a court in Greece recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

In general, yes.

In securitisation transactions in particular, in which the seller is domiciled in Greece or operates through a permanent establishment in Greece and the purchaser is established solely for the purpose of acquiring the business claims and is the issuer of the bonds, article 10 of Greek law 3156/2003 applies (the Securitisation Law). Pursuant to the Securitisation Law, unless otherwise provided in the respective receivables sale agreement, the agreement is governed by the relevant GCC provisions, while the transfer agreement by the provisions regulating assignment contracts of the GCC, to the extent these are not contrary to provisions of the Securitisation Law. In most public Greek securitisations, the receivables sale agreement is governed by foreign law, while the transfer (assignment) agreement (and thus the registration obligation rising there from) is governed by Greek law.

In securitisation transactions where the seller is the government or a government agency, specific provisions apply; however, transfer formalities notwithstanding, the seller and the purchaser may submit the receivables sale agreement to foreign law.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Greece, will a court in Greece recognise that sale as being effective against the seller, and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

A Greek court will recognise the sale as effective, without taking into consideration any foreign law, as long as Greek law requirements (especially the registration obligation as regards the transfer of in rem rights over the receivables) are met; in particular as regards bankruptcy of the (Greek) seller, it should be noted that the Securitisation Law provides for the ring-fencing of the securitisation transaction against the subsequent bankruptcy of the seller.
Recievables are sold under a sales contract. The transfer thereof is effected through assignment of the underlying claims (GCC 455 et seq.) whereby the assignor (seller) transfers its claim against an obligor to the assignee (purchaser).

Under more complex structures of receivables’ sales, claims may be transferred through factoring or forfeiting agreements (law 1905/1990), certain forms of covered bonds (law 3601/2007) and securitisation transactions (Securitisation Law).

Under such transactions, the law and relevant documentation usually refers to “sale” or “transfer” of claims.

In sales effected under the general provisions of the GCC, the assignment of the claim must be notified to the obligor, the notification (by either the assignee or the assignor) being a condition to the effectiveness of the transfer vis-à-vis the obligor.

Under securitisation transactions, notification is effected by registration of the transaction with the competent land registry. Registration is provided as a condition to most of the privileges set out in the Securitisation Law.

Notwithstanding effects of the notification (or registration, as the case may be) but given that the assignment agreement is binding upon its parties, it is debatable whether the purchaser may further transfer the assigned claim prior to the notification, the jurisprudence and legal theory having different views on the matter.

In any case, prior to the notification (or registration, as the case may be) the purchaser (and any of its transferees) bears the risk of: (a) payment to the assignor, which releases the obligor from all its liabilities under the relevant contract; (b) enforcement of the assignor’s creditors against the receivable in question which is considered to be part of its property; and (c) assignor’s insolvency taking into account that the said receivable is considered to be part of the bankruptcy property.

Promissory Notes and other forms of debt marketable instruments are transferred following a relevant agreement, endorsement and delivery to the purchaser (or a person acting on its behalf).

Mortgage loans and other secured receivables are transferred in accordance with the abovementioned (under question 4.2) procedure. The securities of such loans and receivables, being ancillary rights, are transferred with the respective secured claim subject to relevant formalities (see question 4.11).

Notification requirements are set out under question 4.2. The obligor’s consent is not required for the transfer of the receivable, unless otherwise provided in the underlying contract.

The sale and assignment of receivables that is subject to the Securitisation Law may be agreed without the obligor’s consent, irrespective of contractual provisions in the respective contracts imposing consent as a condition precedent to the transfer of the
underlying receivables. However, the obligor may invoke against the assignee any rights and defences (including set-off) that it had against the assignor prior to the notification, subject to certain conditions.

**4.5 Notice Mechanics.** If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Notice of assignment need not be effected in any particular form (special notification procedures being provided for assignments by way of security), provided that there is sufficient evidence of receipt of the notification by the obligor. One of the most usual methods of delivery is notice by a court bailiff.

Registration of assignments entered into under the Securitisation Law is made to the competent registry by way of submission of a specific form, to which are annexed lists of the assigned receivables. Under the Securitisation Law, the purchaser does not acquire from the transfer any rights against the obligor before such registration is effected.

Specific time limits are not provided by the law, subject to the legal risks that may be incurred prior to the notification (question 4.2). Groups of receivables (including future receivables) may be subject to assignment, provided that they are described in a sufficiently specific way in the respective receivables sale agreement. The nature of the receivables is irrelevant to the notification procedure.

**4.6 Restrictions on Assignment; Liability to Obligor.** Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Greece? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Greece recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Contractual restrictions on assignment/transferability of claims are acknowledged by the Greek courts (but see question 4.4 on the special securitisation transactions regime overriding said arrangements). Such arrangements do not have an *erga omnes* effect, but the assignor may be liable under the contract for any damages resulting from breach of the relevant contractual undertaking.

**4.7 Identification.** Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Assigned claims must be defined or at least be described in a clear and unambiguous way so as to avoid nullity of the transfer due to uncertainty on the transferred receivables; the same applies as regards the identity of the obligor. In case the seller sells all of its receivables other than receivables owed by one or more specifically identified obligors, the receivables are deemed to be sufficiently identified, as long as it may unambiguously be deduced which receivables are transferred.

For the purpose of registrations under the Securitisation Law, a full list of the transferred receivables (identification of the contract, name and address of obligor(s)/guarantors, amount of the receivables, maturity date and securities) must be annexed to the registration form.

Receivables sold under the same sale agreement need not have similar characteristics.

**4.8 Respect for Intent of Parties; Economic Effects on Sale.** If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redeemption without jeopardising perfection?

Greek courts have the authority to examine the true legal nature of any transaction (most commonly ruling whether claims are assigned genuinely or by way of security).

The Securitisation Law requires the sale of the receivables to invoke the applicability of Greek Civil Code provisions on sale of goods; this requirement is further enhanced for banking receivables’ securitisations, where the true sale character of the transaction is assessed pursuant to specific requirements set out by the Bank of Greece. A sale by way of security is incompatible with the abovementioned structure.

Under the Securitisation Law, collection and administration of the transferred claims may be effected by the seller in its capacity as servicer (such structure being the market practice); alternatively, the servicing of the receivables portfolio may be assigned to a credit/financial institution of the EEA (that must have a permanent establishment in Greece, if the receivables are obligations of consumers, payable in Greece) or a third party which has either guaranteed or had undertaken collection of the receivables prior to the completion of the securitisation. The appointment of the servicer must be registered with the competent registry. The purchaser has the right to sell-back all or part of the securitised receivables under the provisions (and using the benefits) of the Securitisation Law, such right not jeopardising perfection of the initial sale.

**4.9 Continuous Sales of Receivables.** Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Subject to the relevant formalities being complied with, continuous transfer is possible whether under simple sale and assignment or pursuant to a securitisation transaction. Please see above question 4.7 as regards the description of receivables.
4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there enforcement between future receivables that arise prior to or after the seller’s insolvency?

Question 4.9 applies accordingly, subject to identification of transferred receivables (see question 4.7). If the receivables arise from a legal relationship that is created post declaration of the seller under bankruptcy, it is uncertain whether the transaction will be ring-fenced against the effects of insolvency.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Question 4.3 applies accordingly.

The formalities required for the creation of a security interest must be repeated to perfect their transfer (i.e. (a) registration of the change of the beneficiary of a mortgage/prenotation of mortgage with the competent land registry, (b) endorsement of marketable instruments, (c) court bailiff service of a pledge over receivables, or (d) registration of floating charge/equipment pledge).

Under the Securitisation Law, the security interests that are ancillary to the transferred receivables are deemed to be transferred to the purchaser; change of the beneficiary of mortgages or other in rem rights, that must be registered with a public record under applicable law, is effected by registration of the certification of registration of the receivables sale agreement form with the competent registry.

5 Security Issues

5.1 Back-up Security. Is it customary in Greece to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No, it is not.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Greece, and for such security interest to be perfected?

This is not applicable – please see question 5.1 above.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Greece to grant and perfect a security interest in purchased receivables governed by the laws of Greece and the related security?

Security over receivables (i.e. pledge of claims) is perfected through notice of the pledge agreement to the obligor (for the relevant formalities, see question 4.11 above).

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Greece, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Greece or must additional steps be taken in Greece?

Whilst the contractual terms of the security agreement may be governed by foreign law, the perfection of the security on a Greek law receivable must be governed by Greek law. Therefore, our response to question 3.1 applies also on the perfection of security interests.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

See questions 4.11 and 5.3 that also apply for the perfection of security interests on such instruments/receivables.

5.6 Trusts. Does Greece recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Greek law does not recognise division between legal and beneficial ownership. Thus, the institution of trust is not recognised as such. As regards collection of the securitised receivables, the seller may collect them in its capacity as servicer (see question 4.8). Given the true sale nature of the transaction and the authorisations contained in the servicer appointment agreement, the transferred receivables are property of the purchaser administered by the servicer.

5.7 Bank Accounts. Does Greece recognise escrow accounts? Can security be taken over a bank account located in Greece? If so, what is the typical method? Would courts in Greece recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Greece?

Escrow accounts are acknowledged under Greek law as a contractual undertaking (account holder name, movement of funds, signing rights to be provided in a relevant contract), without having an erga omnes effect, as opposed to an account pledge. In the event that enforcement measures are initiated against the escrow account or its holder, monies deposited therein are not ring-fenced. For account pledge formalities, see question 5.3 above. For foreign law security agreements, see question 5.4.

As regards securitisations, the account where payments are made under the transferred receivables is a segregated account, pledged in favour of the securitisation noteholders and other creditors, that is held with the servicer and it is ring-fenced against enforcement and insolvency procedures raised against the servicer.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Salaries, pensions and social security benefits deposited directly in
the obligor’s bank account are exempted from attachment in the hands of a third party (i.e. of the bank in which such amounts are deposited). The exemption covers the amounts deposited up to the amount of the salary, pension, and social security benefit each time deposited. Any excess credit balance in the account may be attached.

Special provisions apply with regard to financial collateral arrangements on bank account deposits.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Greece for (a) transactions between unrelated parties and (b) transactions between related parties?

Clawback provisions apply to both related and unrelated party transactions. The “suspect period” is set by the bankruptcy court and may start as early as two years prior to the declaration of bankruptcy by the court. If, during the last 5 years before the declaration of bankruptcy, the bankrupt entity entered into transactions with intent to cause damage to its creditors or to favour some against others, and its counterparty was acting in bad faith, such transactions are revocable. Revocation of transactions may be mandatory or optional, depending on their characteristics.

Kindly refer to question 6.1 on the special ring-fencing regime under the Securitisation Law.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

The insolvency official is not entitled to consolidate assets of the purchaser with those of the seller, unless such assets are subject to the clawback provisions discussed under question 6.3 above.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Greece, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Under the Securitisation Law, the commencement of any insolvency proceedings which may incur a prohibition of or restrictions to the right of, among others, the seller to dispose of the securitised receivables does not affect the validity of the sale and transfer of such receivables. The same applies to future receivables which are generated after the commencement of the said proceedings.

[For as long as the notification of assignment or registration of the securitisation is pending, the receivables form part of the bankruptcy property. Same applies to future receivables whose status does not permit identification thereof (see question 4.7 above).]

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Greece establishing a legal framework for securitisation transactions? If so, what are the basics?

Greece has introduced a special law governing the securitisation of commercial receivables (which include banking receivables) and real estate (the Securitisation Law). In addition, a separate law governs the securitisation of state sector receivables. The Securitisation Law provides for the sale of receivables to special
purpose vehicles, established either in Greece or elsewhere. The purchase of the receivables is funded by the issuance of a bond loan by the spv. The transaction (along with the appointment of a servicer) is registered with the competent registry and benefits from favourable tax regime and enhanced protection against insolvency/enforcement procedures against the seller and the servicer (see above).

7.2 Securitisation Entities. Does Greece have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Under the Securitisation Law, a Greek law spv is established as a societe anonyme with registered shares. The company’s primary corporate body is the shareholders’ general assembly whilst management is carried out by a BoD of at least 3 members. Publicity of certain corporate acts and several accounting obligations must be complied with. Shareholders’ liability is limited to their participation in the company. The Securitisation Law does not include any requirements for non-Greek spvs.

If the spv is a wholly owned subsidiary of the seller, issues may be raised regarding the true sale nature of the transaction, regulatory capital obligations of the seller and accounting obligations. In particular as regards banking securitisations, spvs are usually orphan vehicles established under English law; solo consolidation of such spvs with the originating bank is mandatory under International Accounting Standards; such accounting treatment is irrelevant for capital relief purposes.

7.3 Non-Recourse Clause. Will a court in Greece give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

In case the contract’s governing law is Greek, such choice would in principle be accepted by Greek courts, subject to the restrictions mentioned above under question 2.3.

Whether a contractual provision limiting the recourse rights under foreign law will be found valid and binding by Greek courts depends on the content of such provision and the particularities of the case.

7.4 Non-Petition Clause. Will a court in Greece give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Please see our answer under question 7.3 above.

7.5 Priority of Payments “Waterfall”. Will a court in Greece give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

No. Greek law provisions regulating payments “waterfall” in enforcement procedures are deemed to be overriding mandatory provisions and will thus prevail, under article 9 of Rome I, over all contrary contractual provisions. Please see our answer under questions 2.1 and 2.3 above.

7.6 Independent Director. Will a court in Greece give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Greek courts will recognise and apply foreign law contracts or foreign court decisions to the extent not contrary to public order provisions of Greek law. Societe anonyme companies are to be treated as fully autonomous entities and, as such, their corporate bodies must pursue the company’s corporate interest (failure to do so will incur civil and criminal liabilities – especially as regards the requirement to commence bankruptcy proceedings in case the company is permanently insolvent). Consequently, the described contractual arrangement must prove to serve corporate interest and not deprive its corporate bodies from their powers.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Greece, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Greece? Does the answer to the preceding question change if the purchaser does business with other sellers in Greece?

Under Greek law it is not necessary that the purchaser should be or have been licensed, qualified or otherwise entitled to carry on business in Greece in order to be able to enforce its rights deriving from the securitisation transaction, nor will it be subject to regulation as a financial institution in Greece.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

No licence is required for the seller to continue to enforce and collect receivables, in its capacity as servicer, following their sale to the purchaser.

A summary of the Servicing agreement containing the basic provisions thereof must be registered with the competent registry. The service agreement form should be filled in and submitted each time a servicer (including a replacement servicer) is appointed.

In case the securitised receivables are claims against consumers payable in Greece, the servicer must have a permanent establishment in Greece.

Under Greek law, a non-lawyer cannot appear before a Greek court in the name and on behalf of the claimant (or defendant); therefore, the seller (in its capacity as servicer) may authorise a competent lawyer, so that the latter can act on behalf of the purchaser before Greek courts.

The replacement servicer must have the same characteristics as the initial servicer, namely it must be a credit/financial institution of the
EEA or a third party which has either guaranteed or had undertaken collection of the receivables prior to the securitisation thereof.

8.3 Data Protection. Does Greece have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Greece has transposed EU data protection directives. In general, in Greece, the dissemination of personal data, and of data related to financial behaviour in particular, is restricted through several laws (e.g. laws 2472/1997 and 3471/2006, secondary legislation issued by the Data Protection Authority (DPA), etc.). The processing of data for the purposes of a securitisation transaction must comply with the legislation as in force; however, pursuant to the Securitisation Law such processing does not require prior approval by the DPA or any prior consent by the obligors. The seller may give to the purchaser any data related to the receivables transferred and/or the relevant obligors; so may the purchaser to the bondholders, their representatives and/or the persons participating in the securitisation transaction.

Data protection legislation applies only to natural persons.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Greece? Briefly, what is required?

Yes, the purchaser must comply with all relevant Greek consumer protection laws. For banking receivables, such protections relate to the unilateral change of the interest rates of the receivables, restrictions on enforcement, as well as restrictions and/or requirements for termination of a loan/credit agreement.

Pursuant to law 2251/1994 on consumer protection, consumer protection legislation may also apply to legal entities.

8.5 Currency Restrictions. Does Greece have laws restricting the exchange of Greek currency for other currencies or the making of payments in Greek currency to persons outside the country?

No, it does not. Please note that banking institutions are subject to certain notification and/or report obligations to the Bank of Greece with respect to transfer of funds as well as to obligations for the avoidance of money laundering. The Bank of Greece may conduct controls to ensure that the respective reporting obligations are complied with and impose fines or penalties in case of breach thereof.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Greece? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

In general, payment of interest in Greece to non-Greek beneficiaries will be subject to withholding tax. Whether such tax will be applicable depends on the tax residence of the purchaser and the obligors, the nature of the receivables and the existence of a double taxation treaty between Greece and the country of tax residence of the purchaser.

9.2 Seller Tax Accounting. Does Greece require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

In particular as regards banking securitisations, spvs are usually orphan vehicles established under English law; solo consolidation under current and past banking loan agreements and it is –under current and past practise– transferred by the banks to the obligors of the loans.

9.3 Stamp Duty, etc. Does Greece impose stamp duty or other documentary taxes on sales of receivables?

No, the sale and transfer of receivables pursuant to the Securitisation Law is exempted from all direct or indirect taxes, including stamp duty.

9.4 Value Added Taxes. Does Greece impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Securitisation transactions are exempted from all direct and indirect Greek law taxation. VAT will be applicable on the servicing agreement, if the servicer is not the originator of the receivables of the securitisation portfolio.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

No, the purchaser is not liable for any of the taxation obligations of the seller. Notwithstanding the above, the seller and the purchaser are jointly liable to pay to the Bank of Greece all moneys they collect under the securitised receivables that correspond to the levy of law 128/1975; this levy is imposed on the interest computed under banking loan agreements and it is –under current and past practise– transferred by the banks to the obligors of the loans.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Greece, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Greece?

According to the prevailing legal theory, no. In addition, we are not aware of any case where the Greek tax authorities have considered that any of the purchasers of Greek securitisations are deemed to have a permanent establishment in Greece solely on the basis of the transactions foreseen under the securitisation transaction documentation.
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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Other than with respect to certain types of contracts, there is no general requirement under Hong Kong law that a sale of goods or services be evidenced by a formal contract (assuming “formal” means an agreement be in writing or evidenced in writing). As such, it is possible for a contract to arise solely from the behaviour of the seller and obligor in the absence of a written contract to the contrary.

An invoice, depending on the detail and nature of its terms, may be sufficient to evidence a contract between the obligor and the seller. In particular, an invoice may incorporate, by way of reference, the seller’s standard terms and conditions. Furthermore, a court in Hong Kong may also imply further terms by examining the course of previous dealings between the obligor and the seller or imply terms which may arise by custom or trade usage within a particular industry.

1.2 Consumer Protections. Do Hong Kong’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Yes, there are Hong Kong laws that may limit applicable rates of interest. The Money Lenders Ordinance (Cap. 163) operates to limit rates of interest in certain circumstances. In particular, any loan agreement that contains a provision requiring the payment of interest where:

(a) the rate of interest exceeds 48 per cent. is deemed to be extortionate and the terms of such an agreement are susceptible to amendment by a Hong Kong court; or

(b) the rate of interest exceeds 60 per cent. is rendered unenforceable (together with any security provided to support such loan) and is a criminal offence with a maximum penalty of HK$5,000,000 and 10 years’ imprisonment.

In this context, the Money Lenders Ordinance does not apply to “authorised institutions” as defined in the Banking Ordinance (Cap. 155) nor does it apply to loans made to a company with paid up share capital of at least HK$1,000,000.

A provision in a contract which provides for the payment of an additional sum of money upon breach of the contract may amount to a penalty and be unenforceable under Hong Kong law if the sum stipulated to be paid for such a breach is not a genuine pre-estimate of the greatest conceivable loss likely to be suffered by the non-defaulting party.

There is no general consumer protection legislation in Hong Kong. However, there are specific regulations which are relevant in certain industries, such as insurance and structured products. In addition to the Money Lenders Ordinance, there are also several ordinances of general application which may provide rights to consumers, such as the Control of Exemption Clauses Ordinance (Cap. 71), Supply of Services (Implied Terms) Ordinance (Cap. 457), and Unconscionable Contracts Ordinance (Cap. 458). Please see the response to question 8.4 below for further details.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Contracts entered into by the government or a governmental body are governed by ordinary principles of Hong Kong law, subject to, in the case of a governmental body, any limitations that may be set out in the statutory instrument that establishes such body. Neither sovereign immunity nor crown immunity applies to the Hong Kong government and its entities. The Hong Kong government has effectively waived its immunity from legal proceedings under the Crown Proceedings Ordinance (Cap. 300).

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Hong Kong that will determine the governing law of the contract?

In the absence of a choice of law provision, the courts of Hong Kong would look to the jurisdiction which has the most real and substantial connection to the dispute.
2.2 Base Case. If the seller and the obligor are both resident in Hong Kong, and the transactions giving rise to the receivables and the payment of the receivables take place in Hong Kong, and the seller and the obligor choose the law of Hong Kong to govern the receivables contract, is there any reason why a court in Hong Kong would not give effect to their choice of law?

There is no reason.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Hong Kong but the obligor is not, or if the obligor is resident in Hong Kong but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Hong Kong give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Hong Kong courts will generally give effect to the choice of foreign law, provided that such choice has been made bona fide and is not against public policy.

Notwithstanding the valid choice of a foreign law to govern the receivables contract, Hong Kong mandatory laws may nevertheless apply to certain aspects of any agreement between the obligor and the seller. For example, transfers of an interest in land would be governed by Hong Kong law, irrespective of the otherwise valid choice of a foreign law to govern the contract.

2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Hong Kong?

It is not clear whether the CISG applies in Hong Kong. The Hong Kong Department of Justice does not list the CISG as a treaty applicable to Hong Kong.

Furthermore, there is inconsistent international case law and commentary as to whether declarations made by the People’s Republic of China have:

(a) by an affirmative declaration (as contemplated under article 93 of the CISG), excluded the CISG from applying to Hong Kong (being a territory of the PRC); or

(b) failed to make an affirmative declaration, with the result that (by operation of article 93(4) of the CISG) the CISG automatically applies to Hong Kong.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Hong Kong’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Hong Kong’s laws or foreign laws)?

No, Hong Kong law does not require the sale of the receivables to be governed by the same governing law as the receivables themselves.

However, if the receivables contract is governed by Hong Kong law, the assignment of the receivables would be subject to perfection requirements as established under Hong Kong law. This

is in addition to the issues set out above in the response to question 2.3 (i.e. Hong Kong mandatory laws).

3.2 Example 1: If (a) the seller and the obligor are located in Hong Kong, (b) the receivable is governed by the law of Hong Kong, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Hong Kong to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Hong Kong, will a court in Hong Kong recognise that sale as being effective against the seller, the obligor, and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, a court in Hong Kong will recognise the sale as being effective against the seller, the obligor, and third parties.

For the response to this question and the responses to questions below, we have assumed that “located in Hong Kong” means that the relevant party is (for a company) incorporated in Hong Kong, rather than a non-Hong Kong company that has an established place of business in Hong Kong and registered under Part XI of the Companies Ordinance (Cap. 32). Whether the sale of the receivables is upheld as a “true sale” against the insolvent estate of a non-Hong Kong company depends on the insolvency laws of the jurisdiction of incorporation of that company.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Hong Kong, will a court in Hong Kong recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Yes, a court in Hong Kong will recognise the sale as being effective against the seller and third parties.

3.4 Example 3: If (a) the seller is located in Hong Kong but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Hong Kong recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Hong Kong own sale requirements?

In the event of enforcement against the seller before any insolvency proceeding in relation to it, it is likely that a Hong Kong court will recognise the sale as valid and enforceable against the seller (assuming of course the receivables purchase agreement is itself valid, binding and enforceable). As the relevant agreements in this scenario are governed by non-Hong Kong law, the situation envisaged here is enforcement post-foreign judgment against the seller. The response to this question therefore turns on whether a Hong Kong court would recognise and enforce a foreign judgment against the seller (for example, it may not be enforceable if it is against Hong Kong public policy).

However, notwithstanding that the transaction is recognised as a sale by the laws of the obligor’s jurisdiction, in the event of
insolvency proceedings commencing with respect to the seller, it is likely that a Hong Kong court would apply a Hong Kong law true sale analysis to the transaction to determine whether it is treated as a true sale in accordance with the legal tests set out in the response to question 4.8 below.

3.5 Example 4: If (a) the obligor is located in Hong Kong but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Hong Kong recognise that the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Hong Kong own sale requirements?

There is no requirement in Hong Kong that the sale be in accordance with Hong Kong law for it to be enforceable against the obligor (subject to the limitations listed in response to question 4.4). However, the question of whether the receivable is enforceable by the purchaser against a Hong Kong obligor depends on the nature of the receivable and the identity and characteristics of the obligor (for example, if the obligor is a consumer, he or she may have remedies available under Hong Kong law notwithstanding the location of the seller or purchaser or the governing law of the receivable – as further set out in the response to question 8.4 below).

3.6 Example 5: If (a) the seller is located in Hong Kong (irrespective of the obligor’s location), (b) the receivable is governed by the law of Hong Kong, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Hong Kong recognise that the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Hong Kong and any third party creditor or insolvency administrator of any such obligor)?

As noted in the response to question 3.4 above, on the insolvency of the Hong Kong seller, a court in Hong Kong is likely to apply a Hong Kong law true sale analysis to determine whether it is treated as a sale or a secured transaction.

For an obligor located in Hong Kong, the same considerations as set out in the response to question 3.5 apply. True sale analysis is not relevant with respect to the obligor, as its obligations under the receivables contract remain unchanged irrespective of whether the sale amounts to a sale or to a secured transaction between the seller and the purchaser.

4 Asset Sales

4.1 Sale Methods Generally. In Hong Kong what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The customary method to sell receivables in Hong Kong is a legal or equitable assignment by way of sale. However, receivables may also be sold by way of novation or through a declaration of trust.

The term “transfer” has no legal meaning under Hong Kong law but is typically synonymous with a legal or equitable assignment. A legal assignment is an assignment which meets the criteria set out in Law Amendment and Reform (Consolidation) Ordinance (Cap. 23), being:

(a) an absolute assignment by way of sale of the assignor’s entire legal interest in the receivables;
(b) in writing and signed by the assignor; and
(c) with express written notice of the assignment (in particular the date of assignment and the identity of the assignee) given to the obligor. The notice need not be in any particular form and may be given by any party.

An equitable assignment is an assignment which has not met all the required criteria necessary to create a legal assignment. Typically an equitable assignment arises due to a commercial or practical decision to not provide notice to the obligor at the time of assignment. Nevertheless, courts of Hong Kong recognise an equitable assignment, but such an assignment has a number of practical and legal limitations (for example, priority is affected as set out in the response to question 4.2 below).

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The requirements to perfect the sale of receivables are, for an assignment by way of sale, set out in the criteria to establish a legal assignment in the response to question 4.1 above.

Perfection and priority against a subsequent good faith purchaser for value of the same receivables requires notice to be given to the obligor before the subsequent good faith purchaser has given its notice to the same obligor (unless the subsequent purchaser had knowledge of the earlier assignment at the time that they were assigned the same receivables).

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The sale of promissory notes is governed by the Bills of Exchange Ordinance (Cap. 19), which requires transfer by way of delivery or by way of endorsement and delivery.

For the sale of mortgage loans, the Conveyancing and Property Ordinance (Cap. 219) requires that the assignment of any equitable interest in land be created or disposed of by an instrument in writing and signed by the person creating or disposing of the equitable interest. The assignment of a mortgage loan must also be registered with the Land Registry pursuant to the Land Registration Ordinance (Cap. 128) within one month of the assignment in order to maintain priority over subsequent interests in the same land.

Marketable debt securities may either be in bearer form or registered form. By their very nature, bearer notes only require delivery of the relevant instrument from the seller to the purchaser in order to transfer title. The sale and transfer of ownership of registered notes requires an entry to be made to a register maintained by a registrar on behalf of the issuer of the registered notes. It is only when such register is updated that legal ownership in the notes is transferred from the seller to the purchaser. Please see the response below to question 5.5 for further information.
Notification to the obligor is not mandatory in order for the sale of receivables to be effective against the obligor or creditors of the seller. However, as noted above in the response to question 4.1, there are a number of practical and legal difficulties that arise from an assignment without notice to the obligor (that is, an equitable assignment rather than a legal assignment). Therefore, unless notice is given, the following issues may arise:

(a) the obligor may discharge its liabilities by making payments solely to the seller, regardless of whether the seller must account to the purchaser for moneys received from the obligor;

(b) the obligor may claim set-off and raise equities and defences against the seller which it may not have been able to raise against the purchaser;

(c) as set out in the response to question 4.2 above, a subsequent purchaser of the same receivables may give notice to the obligor prior to the purchaser such that they gain priority;

(d) the purchaser must join the seller to any proceedings against the obligor; and

(e) the seller and the obligor may amend the relevant receivables contract without the consent or knowledge of the purchaser (although, as a matter of practice, the seller would usually covenant not to do so under any receivables purchase agreement).

Consent from the obligor is required where the underlying receivables contract prohibits assignment of the contract to a third party. A sale will not be enforceable against the obligor if the assignment is made in breach of such a prohibition.

The assignment of a contract, where such contract is silent as to the ability of a party to assign its rights, will generally be valid and effective, although Hong Kong law prohibits assignment for certain specific types of contracts or where it is against public policy to do so.

Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must identify the receivables with such specificity such that they are capable of being ascertained, whether they are in existence or will come into existence in the future. Furthermore, a declaration of trust will not be validly established if there is a lack of certainty in the subject matter of the trust (being the receivables in this case).

There is no requirement that receivables share any objective characteristics. It is sufficient to identify all receivables of the seller for the purposes of ascertaining which receivables are to be the subject of any receivable sale agreement.

Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The label which parties give to a transaction is not determinative as to the true characterisation of that transaction. As such, the fact that
the parties agree that the transaction be treated as a sale is one factor which a court in Hong Kong would consider when determining whether the transaction is a “true sale” or whether it should be characterised as another type of transaction (such as the granting of security or a secured loan).

The English decision of Re George Inglefield Ltd [1933] Ch. 1 (which has been recently applied by the Hong Kong courts in the decision of Hallmark Cards Inc v Yun Choy Ltd [2012] 1 HKLRD 396) illustrates a number of factors which the court would consider when looking at whether a particular transaction is a sale or whether it amounts to a transaction involving the granting of security. The non-exhaustive factors include the following:

(a) under a sale, the seller is not entitled to recovery of the property sold by returning the purchase money to the purchaser. In contrast, the provider of security is entitled to recover the property that is the subject of the transaction as a right called an “equity of redemption” upon return of the money (together with any interest or other amounts owed);

(b) under a sale, the purchaser is free to sell the property without having to account to any profit to the seller. In contrast, the provider of security is entitled to any surplus arising from the sale of the property (after discharge of any secured obligations) that was subject to the relevant security interest; and

(c) conversely, under a sale, if the purchaser sells the property at a loss, it cannot look to the seller to make good that loss, whereas under a secured transaction, the provider of security may be required to make good that loss to the security taker.

Notwithstanding the factors listed above, courts in Hong Kong (and England) have nevertheless found that a transaction amounts to a sale even though:

(a) the purchaser has recourse against the seller to recover the shortfall if the obligor fails to pay the debt in full;

(b) the purchaser may have to make adjustments and payments to the seller after the full amounts of the debts have been received from the obligor;

(c) the seller remains as servicer and responsible for collections from the obligors; and

(d) the seller assumes interest rate risk through the provision of any interest rate hedging arrangement.

Retaining control over collections will not, of itself, affect the true sale analysis. However, an unfettered right of the seller to repay the purchase price to repurchase all the receivables may undermine the true sale nature of the transaction.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, under Hong Kong law the seller can agree to the continuous sale of receivables.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Yes, under Hong Kong law the seller can agree to assign in equity receivables that come into existence after the date of the receivables purchase agreement. In such a case, the promise to transfer the receivables as they come into existence is enforced in equity so that the purchaser has a right to the receivables as soon as they come into existence. However, notice will still be required to the obligor in accordance with the Law Amendment and Reform (Consolidation) Ordinance to perfect such an assignment.

Note that the sale of any receivable after the date of a winding-up petition (assuming that a winding-up order has been made by a Hong Kong court) is void without court approval.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The response to the question depends on the nature of the asset to which the related security relates. For example, a transfer of a mortgage in Hong Kong would require registration with the Land Registry offices.

In the event that related security cannot be transferred completely, a security taker may be able to rely on an equitable interest rather than a legal interest.

5 Security Issues

5.1 Back-up Security. Is it customary in Hong Kong to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary in Hong Kong to take any form of security interest over the seller’s ownership in the receivables. The reason being is that this may prejudice any true sale analysis as it may show an objective intention of the parties to treat the transaction as a security arrangement rather than a true sale of the receivables.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Hong Kong, and for such security interest to be perfected?

Security created by way of charge over some assets must be registered in accordance with section 80 of the Companies Ordinance (Cap. 32). The requirement to register charges over land and interests in land, charges over book debts of a company and floating charges over the property or undertaking of a company is relevant for receivables purchase and securitisation. “Company” in this context means companies incorporated in Hong Kong and a non-Hong Kong company registered under Part XI of the Companies Ordinance.

Failure to register within five weeks after its creation renders the charge void as against any liquidator of the company and any third party creditor of the company. As such, registration is purely a perfection requirement against third parties and is not a condition to the validity of the charge as against the seller.

Amendments to section 80 of the Companies Ordinance are currently being considered. These amendments may include a shortening of the registration period and changes to the scope of registrable charges.
Perfection (with respect to priority over subsequent purchasers of the receivables) depends on whether the charge is fixed or floating. However, for practical reasons, it is unlikely that a fixed charge will be taken over receivables. Please see the response to question 5.3 below for further commentary on perfection and priority of security interests.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Hong Kong to grant and perfect a security interest in purchased receivables governed by the laws of Hong Kong and the related security?

The formalities required to perfect security interests granted by the purchaser depends on the nature of the security interests granted over the purchased receivables.

For security interests granted by assignment in way of security, the legal assignment requirements as set out in the response to question 4.1 apply.

Security interests may also be granted by way of mortgage, fixed charge or floating charge. Although other forms of consensual security exist under Hong Kong law (i.e. the pledge and lien), it is most likely that such security is provided by way of charge or mortgage. In Hong Kong, financing is usually secured by means of taking a fixed charge (or mortgage) over real property owned by the purchaser and a floating charge over the assets and undertaking of the purchaser.

Registration is required for some fixed charges, and all floating charges, in accordance with the Companies Ordinance (being within five weeks of the date of creation of such charge). Failure to register in accordance with the Companies Ordinance will render the charge void as against the liquidator of the purchaser as well as its creditors.

Perfection (with respect to priority over subsequent purchasers or subsequent chargors of the same assets) depends on whether the charge is fixed or floating. Assuming that the third party buyer is acquiring the receivables in good faith and for value, the question of whether such a third party buyer acquires priority over the previous security taker turns on the question of what notice such a third party buyer actually had or is deemed to have (constructive notice).

In the case of a fixed charge, the chargor has neither actual nor ostensible authority to deal with the assets free of the fixed charge. As such, provided that the third party purchaser has actual notice (irrespective of whether they had notice of the terms of the relevant charging document) or deemed constructive notice of the existence of a fixed charge, the third party purchaser will have priority over the first security taker.

However, the application of the doctrine of constructive notice in relation to the existence of a floating charge is not so straightforward, as a third party subsequent purchaser (or subsequent chargor) is entitled to assume that the seller has the freedom to dispose of the receivables without actual notice to the contrary. As such, without actual notice of the content of the relevant charging document, establishing notice of any negative pledge or other restriction on disposal of the relevant asset is more difficult to achieve.

In either case, when determining priority between competing interests, a party will be held to have constructive notice of the existence of the fixed or floating charge on the basis of whether it could reasonably have been expected to search the register. That means that, for example, a third party purchaser buying goods in the ordinary course of business is unlikely to search the register whereas a financial institution taking security is likely to have deemed constructive notice of the existence of the charge.

With respect to notice of the contents of a charging document, the Hong Kong decision of ABN Amro Bank NV v Chiyu Banking Corporation Ltd and Ors [2000] 3 HKC 381 held that it is only where a document must necessarily affect the title of third parties that notice of its existence would constitute constructive notice of the contents of that document. This reiterates the different approach that a court would take deeming constructive notice of the restrictions that apply to a fixed charge compared to the restrictions that may arise from a document granting a floating charge.

To the extent that security relates to assets such as land, ships or aircraft, special registration requirements apply under Hong Kong law.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Hong Kong, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Hong Kong or must additional steps be taken in Hong Kong?

If the purchaser is a non-Hong Kong company that is registered under Part XI of the Companies Ordinance, it will be required to register any security in accordance with Hong Kong law (for example, a floating charge will need to be registered in accordance with the Companies Ordinance, notwithstanding that the security interest is valid and perfected under the laws of the purchaser’s country).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security over insurance policies is typically achieved through assignment of the rights, title, interests and benefits in the insurance policy as well as an assignment of any proceeds received under such insurance policy to the secured party (or security trustee). An additional measure that is typically taken by secured parties is to have the secured party (or security trustee) recorded as a “loss payee” under the relevant insurance policy.

Security over promissory notes or marketable debt securities (in each case, where they are in definitive bearer form) is usually taken by way of a pledge – although definitive bearer instruments are very uncommon nowadays. Security over bearer instruments may also be made by such instruments being mortgaged by delivery.

Taking security over marketable debt securities is complex and depends on a number of factors. However, key points are summarised below.

If the debt securities are not cleared – for a legal mortgage, the security taker’s name and details would be entered on the register maintained by the registrar of the relevant issuer until such time as the obligations of the security provider are discharged. For an equitable mortgage or charge, the security provider completes all necessary transfer certificates but transfer by way of registration is not effected until enforcement steps are undertaken by the security taker.

If the debt securities are cleared – for a legal mortgage, the security taker’s name would be entered into the relevant securities account of an intermediary/custodian who itself holds an interest directly
from the issuer or (as is most likely the case) from a higher-tier intermediary. Alternatively, security may be taken by way of an assignment of rights against the relevant intermediary together with an assignment of the rights, title and interests in, or relating to, the debt security.

Security taken over mortgage loans would typically be required to be registered with the Land Registry in Hong Kong in accordance with the Land Registration Ordinance (Cap. 128) as it creates or transfers an interest in real property. Please see the response to question 4.3 above for further information.

### 5.6 Trusts. Does Hong Kong recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, trusts are recognised under Hong Kong law.

### 5.7 Bank Accounts. Does Hong Kong recognise escrow accounts? Can security be taken over a bank account located in Hong Kong? If so, what is the typical method? Would courts in Hong Kong recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Hong Kong?

Yes, escrow accounts are recognised under Hong Kong law.

Security is typically taken over a bank account located in Hong Kong by the granting of either a fixed charge or a floating charge (which may crystallise (i.e. convert) into a fixed charge upon the occurrence of a default or other like circumstance under the relevant transaction documents).

A court in Hong Kong would generally recognise effective foreign law governed security over a bank account in Hong Kong, although ideal practice would be to have security over a Hong Kong bank account governed by Hong Kong law to minimise delays or complications in enforcement.

### 5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

In general a secured party would control all cash flowing in and out of a bank account during enforcement. The ability of the secured party to enforce the security would remain subject to the terms agreed in the relevant security document establishing a charge over the bank account and, in particular, whether a floating charge over the bank account has crystallised into a fixed charge.

### 5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes. The granting of a floating charge over the bank account provides for (prior to crystallisation) the chargor to access funds in accordance with the terms and conditions of the relevant security document.

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### 6 Insolvency Laws

#### 6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insololvency proceeding, will Hong Kong’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Insolvency proceedings with respect to the seller will not affect the rights of the purchaser if the sale meets the requirements of a “true sale” or legal assignment under Hong Kong law.

The situation will be different if the sale was conducted as an equitable assignment (rather than a legal assignment or through novation). On the making of a winding-up order, or on the appointment of a provisional liquidator, with respect to the seller, it may not be possible to compel the seller to perform its obligations under the relevant transaction documents without leave of the court.

If a transaction, which was intended by the parties to be a sale, is subsequently recharacterised as a secured transaction under Hong Kong law, there is a risk that such a transaction would be held void against the liquidator of the seller as well as creditors of the seller due to lack of registration in accordance with the Companies Ordinance. There are no formal corporate rescue procedures in the present regime in Hong Kong. With the introduction of the new Companies Ordinance scheduled for 2014, all of the sections except for the prospectus regime and the winding-up and insolvency provisions will be regulated by the new ordinance. These remaining sections would remain under the old Companies Ordinance and will be renamed as the “Companies (Winding Up and Miscellaneous Provisions) Ordinance” (CWUMPO).

The CWUMPO will introduce a policy called provisional supervision. This can be initiated by filing a notice with the Companies Registry (without requiring court approval). This would then create a moratorium for, initially, a 45-day period, where the provisional supervisor would prepare a voluntary agreement. Creditors will be able to extend the 45-day period up to a maximum of six months. A court will be able to extend the period for as long as it deems necessary.

Discussions regarding various exemptions to this arrangement are still taking place and are yet to be finalised.

#### 6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Please see the response to question 6.3 below.
There are a number of circumstances where pre-insolvency transactions may be set aside:

(a) **unfair preference** (Companies Ordinance, section 266(1) and Bankruptcy Ordinance (Cap. 6), section 50) – any disposition of any asset within six months (or two years for an unfair preference to an associate) before the commencement of winding-up of a company may be set aside where (i) it puts a person in a better position that it would otherwise have been on the insolvency of the company, and (ii) the company was influenced by a desire to create such preference;

(b) **anti-deprivation rule** – any agreement which, on insolvency, increases a creditor’s claim or transfers assets to a particular creditor, is void. There is no preference or suspect period;

(c) **invalidation of floating charges** (Companies Ordinance, section 267) – any floating charge created within one year before the commencement of winding-up of a company may be set aside where the company was insolvent or became so as a result of the entering into the charge or associated transactions, except to the extent of the value of any consideration received by the company on, or after, the creation of such floating charge (i.e. the floating charge remains valid to the extent that it secured fresh funds);

(d) **extortionate credit transactions** (Companies Ordinance, section 264B) – a transaction entered into within three years of the commencement of winding-up of a company may be set aside where payments in relation to such a transaction are considered grossly exorbitant or the terms of the credit grossly contravene ordinary principles of fair dealing;

(e) **transactions defrauding creditors** (Conveyancing and Property Ordinance (Cap. 219), section 60) – any disposition of property made with the intent to defraud creditors may be voidable. There is no preference or suspect period. However, such a claim would need to be made by a person prejudiced by such a disposition and would be subject to normal limitation periods; and

(f) **disclaiming of onerous property** (Companies Ordinance, section 268) – the liquidator of a company may disclaim onerous property, which includes unprofitable contracts, effectively converting a counterparty’s rights under the relevant agreement into an unsecured claim. Again, there is no preference or suspect period.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

There are limited circumstances under Hong Kong law where liabilities of a company may be imposed on another company. The typical circumstances are where the company was formed principally as a sham, to evade existing liabilities or to perpetrate a fraud.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Hong Kong, what effect do these proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

The commencement of insolvency proceedings would have no immediate legal effect on either the sale of receivables after such proceedings have commenced or the sale of receivables that have come into existence after such proceedings have commenced. The general rule is that insolvency does not terminate contracts nor extinguish rights, although remedies are restricted post-insolvency.

Example: in a case where a company has granted a winding-up order with respect to a party, any disposition of the assets of such a party from the date that the winding-up petition was presented is void (or deemed void) unless the court otherwise approves.

Notwithstanding this, if there has been a true sale of the future receivables (for example, such that legal assignment has been perfected by the purchaser giving notice to the obligors), then subject to the issues outlined in the response to question 6.3 above, the seller’s insolvency would not affect the purchaser’s rights in the relevant receivables.

**7 Special Rules**

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Hong Kong establishing a legal framework for securitisation transactions? If so, what are the basics?**

There are no laws in Hong Kong specifically for securitisation.

**7.2 Securitisation Entities. Does Hong Kong have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

There are no laws in Hong Kong specifically for the establishment of special purpose vehicles.

**7.3 Non-Recourse Clause. Will a court in Hong Kong give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the recourse of parties to available funds?**

It is likely that a Hong Kong court would give effect to a non-recourse clause, although there is no case law to date in Hong Kong which has considered its validity.

**7.4 Non-Petition Clause. Will a court in Hong Kong give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

It is likely that a Hong Kong court would give effect to a non-petition clause, although there is no case law to date in Hong Kong which has
considered its validity. However, enforcing such a clause to prevent a party from taking legal action would require a court to exercise its discretion as to whether to grant an injunction or not—i.e., injunctive relief is not a right per se available to a plaintiff under Hong Kong law.

Similarly, the court in Hong Kong retains the discretion under the Companies Ordinance to have a company wound up where it is, in the opinion of the court, just and equitable to do so. As such, although unlikely, it is possible that a court exercises such discretion to allow insolvency proceedings to commence against the purchaser or another person.

### 7.5 Priority of Payments “Waterfall”. Will a court in Hong Kong give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Waterfall or payment priority provisions are likely to be valid and enforceable under Hong Kong law for a Hong Kong law governed document, although this has not been considered by any Hong Kong court to date. Assuming validity and enforceability under Hong Kong law, there is no reason why a court in Hong Kong would not give effect to such a clause with respect to a Hong Kong entity for a contract governed by a foreign law.

Although not binding on a Hong Kong court, the recent English Court of Appeal decision of *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 has also recently affirmed the validity of “flip-clauses” which have the effect of altering the priority of payments upon an event of default (including insolvency) of a party to an agreement containing such a clause. As such, it is likely that a Hong Kong court would also uphold the validity of a “flip-clause” and, by necessary extension, the validity in general of priority of payment provisions.

### 7.6 Independent Director. Will a court in Hong Kong give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Provided that directors act in accordance with their fiduciary duties as directors and any requirements as set out in the Companies Ordinance and the Hong Kong listing rules (if applicable), there is no specific law which would prohibit contractual provisions or provisions in the company’s memorandum and articles of association that prevent a director from acting or not acting in particular circumstances. Of course, such provisions would remain subject to principles of general law, such as contracts being void for public policy reasons or illegality.

### 8 Regulatory Issues

#### 8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Hong Kong, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Hong Kong? Does the answer to the preceding question change if the purchaser does business with other sellers in Hong Kong?

Depending on the nature of the receivables, the purchaser may be required to obtain a particular licence or be subject to regulations. For example, the receivables may be relevant to business regulated by the Money Lenders Ordinance or the Banking Ordinance. If so, the purchaser will need to obtain the required licences or approvals before purchasing the relevant receivables.

Non-Hong Kong companies, irrespective of whether they are required to register under Part XI of the Companies Ordinance, must register in accordance with the Business Registration Ordinance (Cap. 310) if it is carrying on in Hong Kong “any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain”. Please see the commentary below for question 9.6 as to whether mere ownership of receivables may result in the purchaser “carrying on a business” under Hong Kong law.

#### 8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

There are no specific requirements under Hong Kong law to collect and enforce receivables.

#### 8.3 Data Protection. Does Hong Kong have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes, in Hong Kong the Personal Data (Privacy) Ordinance (Cap. 486) governs the collection, use and dissemination of personal data of living individuals. This does not apply to information with respect to enterprises.

The Personal Data (Privacy) Ordinance applies to anyone who collects or uses personal information which is capable of identifying an individual. In such circumstances, the “data user” must comply with a number of data protection principles that are set out in schedule 1 of the Personal Data (Privacy) Ordinance.

The Code of Banking Practice may also apply if the relevant entity is an “authorised institution”—please see the response to question 8.4 below. This imposes on such authorised institutions a duty to maintain privacy when handling information relating to individual customers.

Data about, or provided by, obligors may also be protected by more general Hong Kong legal and regulatory principles that require the protection of confidential information. Largely, these apply irrespective of the legal structure of the obligor, but their precise application depends on the circumstances.

#### 8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Hong Kong? Briefly, what is required?

Yes, a purchaser would be required to comply with certain consumer protection laws to the extent they apply with respect to the nature of the receivables and the identity and nature of the purchaser.

In particular (but not necessarily exhaustive):

(a) the Banking Ordinance (Cap. 155) and the Code of Banking Practice where the purchaser is an “authorised institution” as defined in the Banking Ordinance—authorised institutions are expected to act in accordance with the Code when dealing with individual customers;
9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Hong Kong? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

No, there is no withholding of taxes in Hong Kong.

9.2 Seller Tax Accounting. Does Hong Kong require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No, there is no specific accounting policy to be adopted for tax purposes in the context of securitisation. Hong Kong companies are required under the Companies Ordinance to prepare financial statements that give a true and fair view and are expected to prepare such statements under local GAAP (Hong Kong Financial Reporting Standards).

9.3 Stamp Duty, etc. Does Hong Kong impose stamp duty or other documentary taxes on sales of receivables?

No, there is no stamp duty on the sale of receivables. There is, however, stamp duty imposed on the transfer of interests in land (including the transfer of mortgages – although the collector of stamps in Hong Kong has been willing to adjudicate that a mortgage transfer is not subject to stamp duty) as well as on certain transfers of stock.

On 23 February 2013, new stamp duty rates for the sale or transfer of immovable property were introduced, ranging from 1.5 per cent. up to 8.5 per cent.

9.4 Value Added Taxes. Does Hong Kong impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

There is no value added tax, sales tax or other similar taxes in Hong Kong.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

There are no such taxes applicable in the context of the sale of receivables. However, under Hong Kong law, tax may be recovered from a third party if the taxpayer is in default of their taxation payment obligations. Such outstanding taxes may be recovered from any third party who (i) owes or is about to pay money to the taxpayer, or (ii) holds money on account of another person for payment to the taxpayer, or (iii) has authority to pay money from some other person to the taxpayer. Failure to comply with a notice from the Commissioner of Inland Revenue may result in the third party becoming personally liable for the whole of the tax that was to be paid.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Hong Kong, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Hong Kong?

There is a profits tax payable by every person “carrying on a trade, profession or business in Hong Kong” in respect of profits “arising or derived from Hong Kong … from such trade, profession or business” (Inland Revenue Ordinance (Cap. 112)).

Whether a person is carrying on business is ultimately a question of fact having regard to the circumstances as a whole and determined by a number of indicia, with no single indicia being determinative. However, it is important to note that courts in England have considered that the passive receipt of share profits was held to be a business (IRC v Korean Syndicate Ltd (1921) 3 KB 258) as well as passive receipt of a fixed annuity (South Behar Railway Co Ltd v IRC (1925) AC 476). As such, it not possible to categorically come to the conclusion that the mere purchase of receivables will necessarily lead to the conclusion that no tax liability will arise in Hong Kong. Therefore, to ensure tax neutrality of a vehicle established in Hong Kong, it is important to ensure that its profit matches its allowable deductions.
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With the largest securitisation practice in the region, King & Wood Mallesons remains at the cutting-edge of new product development by financial institutions, investment banks and corporates. We have been involved in almost every landmark securitisation transaction in the Australian market and an increasing number in Asia.

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Chapter 20

India

Dave & Girish & Co.

Mona Bhide

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) It is not necessary under the Indian Contracts Act, 1872 that the contract for sale of goods or services be made in writing for it to be enforceable. However, in case of an assignment/securitisation, in order to ensure an undisputed flow of receivables it is advisable that the underlying contracts which are proposed to be assigned are in writing and if one of the counterparties qualifies for a registration it should also be registered with the Central Registry (“CERSAI”) set up under the Central Registration of securitisation Asset Reconstruction and Secured Interests of India Act, 2002. An invoice coupled with a delivery receipt would also be sufficient evidence for sale of goods. However, an assignment of the debt will be required to be evidenced by a written document that is duly stamped and registered with the CERSAI (facility available only to qualified lenders).

(b) To enforce the sale, an invoice would be sufficient evidence, except that in cases of assignment of book debts, in order that the transaction meets with the “true sale” criteria, in order to prove that the terms of assignment are in compliance with the Guidelines, it will be necessary to have a written document for assignment.

(c) A contract can be proved by the performance of the parties. If both parties perform their respective obligations, the contract becomes enforceable. However, such contracts are not easy to enforce as the evidence for such performance having been completed has to be proved beyond doubt. This is another reason why a written evidence of the assignment as and by way of an agreement between the parties is necessary.

1.2 Consumer Protections. Do Indian laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owed by them?

(a) With respect to lending transactions, we do have statutes applicable in each state, which require each lender (which is not registered as a bank), to register as a moneylender. The moneylenders’ statute also prescribes the maximum rate of interest that can be charged by a moneylender.

With a view to provide reliefs to farmers and other small entrepreneurs, some states in India have enacted laws/issued guidelines with respect to micro loans and limits have also been prescribed with respect to the rate of interest that can be charged on micro loans.

The rate of interest charged on late payments is based on the contract agreed by the parties in writing. While there is no prescribed rate of interest on late payments, if a matter is taken to court, the court may not award the interest as was agreed by the parties if the same is very high.

(b) While there is no statutory right to recover additional payment by way of interest on late payments, it is granted on equitable grounds in most cases. Where parties have agreed in writing under a mutual agreement to a rate of interest to be charged, the courts would allow that rate of interest. However, if the court finds that the rate agreed is very high as compared to the current rate of interest prevailing in the market, the court may reduce the same at its discretion.

(c) No, consumers do not have a right to cancel the receivables except in case of a prepayment. Even prepayments will be allowed subject to such right being available under the underlying contract or unless mutually agreed by all the concerned parties to the contract.

(d) Where a consumer is not informed about the assignment, the consumer has a right to continue to pay the original creditor/assignor. The consumer can also stop making payments if the original creditor undergoes a liquidation or becomes a sick company within the meaning of the Sick Industrial Companies Act, 1985 and/or is referred to the Board of Industrial and Financial Reconstruction on account of its net worth being totally eroded in cases where the consumer is not aware of the assignment.

The above reply is on the assumption that the underlying contract document does not restrict assignment or require any specific permission from the consumer.

Consumers have a right to challenge any unfair trade practice and any restrictive trade practices in special forums set up for this purpose. We also have a consumers’ forum that hears complaints of consumers and decisions are binding on all.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of these receivables?

There is no different law that applies to the sale of receivables to the government or governmental agencies. However, in case of bankruptcy of a company which is a government-owned company.
set up in India under a separate statute, the procedure for collection can be different and would be as prescribed under such statute.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in India that will determine the governing law of the contract?

If all the parties to a contract are parties residing in India, even if the governing law of a contract is not specified in the contract, the governing law of such a contract will be Indian law by default.

Where, however, the contract is cross-border in nature and involves parties residing in different jurisdictions or where the subject matter of the contract is located in a foreign jurisdiction or where performance of the contract is carried out in a foreign jurisdiction and if the governing law is not specified in the agreement, the governing law of that contract will be decided having regard to the intention of the parties, and the law of the country with which it is most closely connected the laws of jurisdiction in which parties are located and laws of the country in which the contract is to be performed. The Indian courts would apply the principles of private international law to decide any dispute arising with respect to the governing law of a cross-border contract.

2.2 Base Case. If the seller and the obligor are both resident in India, and the transactions giving rise to the receivables and the payment of the receivables take place in India, and the seller and the obligor choose Indian law to govern the receivables contract, is there any reason why a court in India would not give effect to their choice of law?

No, Indian courts would definitely give effect to the choice made by the parties.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in India but the obligor is not, or if the obligor is resident in India but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in India give effect to the choice of foreign law?

Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such that between the seller and the obligor under the receivables contract?

(a) If the parties to a contract are persons resident in India and the contract is not relating to a cross-border transaction, the contract cannot be governed by a foreign law and Indian law would apply by default.

(b) In the case of a cross-border contract, the parties to the contract are at liberty to choose the law of the jurisdiction in which either of the parties to the contract reside. In case they are unable to select either of the laws then the parties can select any neutral law if such law is more commercially developed and is commonly used in similar transactions.

However, in both the cases (a) and (b), if the governing law of the contract is a foreign law and it is sought to be enforced in India, Indian courts will refuse to enforce the contract if the obligation sought to be enforced in India is contrary to Indian law or contrary to public policy. Cross-border assignments of receivables would be required to be in compliance of the FEMA.

For example: the governing law with respect to a contract relating to an immovable property in India cannot be a foreign law.


3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does the Indian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Indian laws or foreign laws)?

No, there is no legal requirement that the law governing the underlying transactions should also be the law governing the assignment.

However, if the same law governs both the contracts, it would reduce the complications that may arise on account of contradictions or conflicts in law situations, if any, between the two different governing laws.

3.2 Example 1: If (a) the seller and the obligor are located in India, (b) the receivable is governed by Indian law, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of India to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Indian law, will a Court in India recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

There are certain restrictions under the Foreign Exchange flow in and out of India. Where such receivables arise out of the loans advanced by the seller, the sale in favour of a non-resident will not be allowed unless a specific permission is first obtained from the Reserve Bank of India. Also where the receivables are trade receivables the same will have to be compliant with the Factoring Act, 2011. Cross-border securitisation/assignments in favour of non-residents would require an approval under FEMA/permission from the Reserve Bank of India.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside India, will a Court in India recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Yes, the Indian courts should recognise the sale. The laws applicable to the obligor are only with respect to the obligations of the obligor. With respect to a foreign purchaser, if the sale is to be enforced in India against the seller in India, the Indian courts would enforce the sale, unless the performance of the obligations has become illegal under Indian law. As mentioned above, the sale to a non-resident would have to be made with the permission of the Reserve Bank of India or should be carried out under the Factoring Act, 2011.
3.4 Example 3: If (a) the seller is located in India but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a Court in India recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with India’s own sale requirements?

No, for the sale to be effective against the seller the sale will have to be enforceable under, and in compliance with, Indian law.

3.5 Example 4: If (a) the obligor is located in INDIA but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a Court in INDIA recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with INDIA’s own sale requirements?

The sale will have to be in compliance with the Foreign Exchange Regulations as applicable at the time of sale and also in compliance with all applicable Indian laws.

3.6 Example 4: If (a) the obligor is located in India but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a Court in India recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with India’s own sale requirements?

(a) If the obligor is located in India, the obligor will be required to comply with Indian law. Also, the transaction that is entered into by the obligor will have to be in accordance with Indian law for it to be enforceable against the obligor in India.

(b) Since the receivables are arising in the seller’s country it is normal that the receivables are governed under the law of the seller’s country.

(c) Choice of a foreign law as the governing law in an international contract is respected and accepted by the Indian courts and in this case, since the law selected is the law of the jurisdiction where one of the parties to the contract resides, the choice will be respected by the Indian courts. However, if the assignment pertains to a financial debt it will be necessary for the assignment to be in compliance with guidelines issued for RBI.

(d) Also, in order for the contract to be enforceable under Indian law, the contract cannot be against the Indian law or Indian public policy.

4 Asset Sales

4.1 Sale Methods Generally. In India what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

In India, a sale of receivables is generally referred to as an assignment of receivables and in cases where there are multiple buyers and the sale is routed through a trust, which is used as a special purpose vehicle to effect the transfer, the transaction is called a “securitisation”. In an assignment transaction it is customary to execute a Deed of Assignment and related documents.

A sale of an account receivable is ordinarily made under a bilateral document structured in the form of a deed of assignment and not as a purchase of receivables. Under the deed of assignment all rights and benefits arising under the underlying transaction are assigned in favour of the assignee.

There is no legal requirement for the obligor to be a party to the assignment because, under Indian law, rights arising under a contract can be assigned without the consent of the obligor unless the contract specifically provides that a prior permission of the debtor should be obtained.

However, in order for the sale/assignment to be binding on the debtor/obligor, it is advisable to give notice of a sale to the debtor, because without such notice the underlying debtor/obligor would be validly discharged by making payments to the assignee. However, if a notice of the assignment/sale is issued by the creditor/assignor to the debtor/obligor payments made to such creditor/assignor would not amount to a valid discharge of the obligations of the debtor/obligor.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The formalities generally are:

The seller and the purchaser enter into an agreement to assign with conditions precedent on the satisfaction of which the sale takes place. In order that the sale is not challenged at a later date most sale agreements are made in writing. It would be necessary to pay the stamp duty on the agreement before it is signed if the same is signed in India.

Stamp duty is required to be paid on the deed of assignment, before it is executed. The stamp duty on a deed of assignment varies from state to state ranging from 3 per cent to 10 per cent depending upon the amount of the receivables assigned and the amount of stamp duty has been remitted to an amount of Rs.100,000 in most of the States.

In the state of Maharashtra, Gujarat, Delhi, West Bengal, Karnataka, Rajasthan, and a few other states notifications have also been issued which have substantially reduced the applicable stamp duties. For example: the stamp duty on a deed of assignment of receivables along with the underlying securities is payable at the rate of 0.1 per cent of the amount of receivables assigned, subject to a maximum of Rs.100,000 (one hundred thousand Rupees) in the state of Maharashtra. The stamp duty varies from state to state so it is ideal that before a transaction is entered into, the rates are checked with the local sources.

If the seller is a corporate, then the purchaser will have to ensure that the purchase of the receivables is made free from any charge created by the seller in favour of any financier. The seller, in that
4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The sale of a promissory note is to be effected by endorsement on the reverse of the promissory note by the person in whose favour the promissory note is issued. If a person, who is a holder in due course, is selling the promissory note (i.e. the person who acquired the promissory note for a valuable consideration) that person also has to endorse the same in the name of the purchaser. Noting may also be carried out where found necessary.

For additional information on perfection, please refer to the answer to question 4.2 above.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

(i) If the contract between the seller and the debtor does not require the consent of the debtor to sell the receivables, the assignor does not need to obtain consent from the obligor.

(ii) Further, under Indian law:
(a) All rights and benefits arising under a contract are assignable unless the contract specifically prohibits assignment.
(b) If the contract prohibits the transfer or assignment of a receivable under the contract, the seller cannot assign the receivable.

Since the assignor does not need the consent of the obligor for such assignment, in case the assignor becomes insolvent after the assignment, the sale would still be valid and there is no limitation, which would require the purchaser/assignee to notify the obligor.

The risk of not giving a notice is that the obligor would be validly discharged if he made payment to the assignor. Further, if the obligor is not informed about the assignment, and if the assignee undergoes liquidation, the obligor can continue to make payments to the liquidator of the assignor and would still get a valid discharge for its payment obligation.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered?

There is no prescribed format for the notice, but it should ideally include the following:
(a) Information that the debt has been assigned.
(b) The date of the assignment or the date from when such assignment is effective.
(c) The name of the assignor and the assignee.
(d) Limitations to the assignment, if any.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in India? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If India recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

(a) Yes, restrictions from assignment are enforceable. However, there cannot be a prohibition on any person from assigning the benefits arising under a contract unless such restriction is reasonable or due to a consideration.
(b) There is an exception with respect to contracts which relate to the performance of personal service, e.g., acting or theatrical performances, etc.
(c) If, in spite of a restriction on assignment the seller still assigns the contract, the assignment may be treated as invalid at the option of the obligor. The obligor in such situation can refuse to recognise the assignee and continue to perform its obligations towards the assignor.

However, where one party is supposed to receive payments from another party, the receiver can always nominate a third party to receive the payments. If no notice of assignment is given, the payee/obligor can make payments to the original payee under the contract and the obligor will get full discharge upon such payment.
4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

(a) Yes, without identifying the receivables, the sale will not be complete and would be vague and, therefore, unenforceable.

(b) The specific information, such as the name (and, if possible, the address of the debtor), the amount of the debt, particulars of the invoice/document giving rise to the debt, the date of invoice/document, payment date, invoice number, etc. will have to be given.

(c) Yes, it would be desirable to have objective characteristics mentioned as it would only help to identify the receivables.

(d) Even in cases where all receivables are being sold, it would be preferable that particulars of the receivables being sold are mentioned because it would help in identification and to distinguish the receivables, which were sold. The list of receivables for an entity actively involved in trading activities changes from day to day and, therefore, it is all the more necessary to identify the receivables which are sold. Moreover, in cases of disputes on account of multiple claimants for the same set of receivables, if the assignment documents provide identification, it helps in proving the ownership.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; and/or (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The court will examine the actual intent if the sale is contested. The mere act of the parties in denominating a transaction as a sale or conveying their intent to sell receivables would not render it to be a true sale, or allow the receivables to be transferred from their books to any other person. The sale will have to meet all the requirements for true sale as prescribed by law and the court would enquire into all economic characteristics to determine whether or not it was a true sale. However, the court would not generally suo moto examine such issues until a dispute is raised before it.

In order for the sale to be a true sale, where either the buyer or the seller (or both) is/are a bank/s, non-banking finance companies/housing finance companies the Guidelines issued by the Bank for the transfer of assets through securitisation and direct assignment of cash flows should be followed. All rights and interest in the receivables will have to pass to the purchaser. If the sale is to be construed as a true sale, it has to be without recourse to the seller. The seller cannot retain credit risk or interest rate risk or retain any benefits either. The seller can, however, as a collection and paying agent or a servicer, participate in the collection of receivables without jeopardising the perfection of the sale.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

While the parties can enter into an agreement to sell as and when the receivables come into existence, the actual assignment can only take place after the receivables come into existence. Hence, if the assignor goes into insolvency after entering into a future contract for sale, the same cannot be enforced. Such a contract for the sale of future receivables will not be bankruptcy remote (i.e. it cannot be enforced in case of the insolvency of the seller), which is one of the essential characteristics for a true sale.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The seller will have to enter into an Agreement for Sale of Receivables. The actual transfer/assignment will take place on the realisation of the receivables, and the seller can give an irrevocable undertaking and power to the assignee to execute the assignment.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforcing transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Assignments can be validly entered into so as to include the assignment of the underlying security interest.

The types of transaction which pose a difficulty are the assignments of mortgage loan receivables where the underlying security is an immovable property. This is because every transfer of an immovable property requires mandatory requirement of registration before the office of the Sub-Registrar of Assurances and such transfer also attracts a heavy stamp duty. The common method therefore prevailing in the Indian market is to transfer only the receivables, and to allow the assignor to continue to hold the mortgage security for, and on behalf of, the purchaser.

5 Security Issues

5.1 Back-up Security. Is it customary in India to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

What we find commonly is a credit enhancement which is generally in the range of 10 per cent to 20 per cent of the total pool size in the form of:

(i) cash collateral in the form of fixed deposits retained with a bank with a lien marked in favour of the assignee;
(ii) bank guarantees; and
(iii) corporate undertakings.
These are credit supports to be used in case of default by the obligors. We have yet to see a back-up security to safeguard a non-perfected sale.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of India, and for such security interest to be perfected?

See the answers to sections 3 and 4 above.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in India to grant and perfect a security interest in purchased receivables governed by the laws of India and the related security?

The question of the purchaser granting a security interest in the receivables does not arise because the purchaser, upon the purchase of said receivables, becomes the full owner and has no obligation to the seller.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of India, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in India or must additional steps be taken in India?

See question 5.3 above.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

While the documents for assignment would be similar in all cases, the requirements would differ on account of a difference in the nature of security interest that is proposed to be transferred in favour of the purchaser/assignee.

If the assignment document relates to a “mortgage interest”, and if the underlying mortgage is also being transferred, then it will have to be registered with the Sub-Registrar of Assurances within whose jurisdiction the immovable property is situated and the registration fee shall also be paid as applicable in the place where the security document is registered. This is in addition to the registration of security interest created under the security document registered with the Registrar of Companies in a case where the security interest is created by a company. However, as explained earlier, if a pool of receivables is being assigned, the common practice is to allow the seller to continue to hold and retain the security interest for, and on behalf of, the purchaser and if the underlying security interest is not being conveyed under the Deed of Assignment, it needs not be registered.

Since the commencement of the operations of the CERSAI, it is necessary to have the sale registered with CERSAI if the seller is a bank or an institution, which qualifies for such registration.

With respect to the assignment of a consumer loan, the underlying security in the form of motor vehicles, insurance policies, debt securities, is generally held in trust for the assignee by the assignor and the assignment documents do not convey the underlying security.

5.6 Trusts. Does India recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Indian law does recognise trusts and accepts a trust arrangement. Once the sale of receivables is complete, the sold receivables, upon collection and before transmission to the purchaser, will be deemed to be held in trust by the seller. However, the document of assignment should have this as one of the covenants by the collection and paying agent/servicer and the assignor.

5.7 Bank Accounts. Does India recognise escrow accounts? Can security be taken over a bank account located in India? If so, what is the typical method? Would courts in India recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in India?

Yes, escrow accounts are legally recognised in India and amounts lying in bank accounts can be held for, and on behalf of, another entity and such accounts can be regarded as bankruptcy remote provided a charge or lien is marked thereon and the bank with whom such account is opened has taken note of such charge. However, such charge will have to be registered with the Registrar of Companies and agreed to in writing.

Yes, the grant of a charge over movable assets of a company can be created in favour of a non-resident company’s obligations in favour of a non-resident creditor.

However, since inflow and outflow of exchange in and out of India is regulated to some extent, if a debt is obtained by an Indian company from a foreign lender it will have to be subject to the external commercial borrowings guidelines. The Reserve Bank of India has also made regulations with respect to the issuance of debentures outside India and the nature of securities that can be created for the same.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

A security over a bank account is possible by the creation of a lien over the account. Where the Banker recognises a lien, no transfer out of such lien marked account by the account holder is possible without the consent of the lien holder/secured party. This would be the case for all funds, and would include future deposits into the account until the lien is removed.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

No, not without the consent of the secured party.
6 Insolvency Laws

6.1 Stay of Action. (a) If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will India’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? (b) Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? (c) Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

(a) No. If the sale of the receivable is perfected, it will be bankruptcy remote and the purchaser will be entitled to collect, transfer or otherwise exercise ownership over the purchased receivables.

(b) The liquidator, in the case of a company, or the receiver or an official assignee, in the case of an individual, is not legally entitled to order or maintain any other action preventing the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables.

(c) If the purchaser is deemed to be a secured party instead of the owner, the secured party can proceed for enforcement of security upon occurrence of an event of default. Alternatively, it would be required to wait in queue before the official liquidator appointed by the Company Court during the liquidation of the company to receive any amounts due, for the distribution before the Company Court hearing the winding up.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

If the transfer of a receivable is a fraudulent preference or a voidable transfer discussed hereinafter, the liquidator will have to make an application to set aside a voidable transfer or fraudulent preference. In such a case the liquidator can also make an interim application for a stay of payments by the debtor to the purchaser.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in India for (a) transactions between unrelated parties and (b) transactions between related parties?

If the transaction involved a fraudulent transfer, i.e., being a transfer made with an intention to avoid payment to a legitimate creditor the sale would be set aside by the liquidator.

6.4 Substantive Consolidation. Under what facts or circumstances, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

The assets of the purchaser purchased from the seller can be consolidated with those of the seller or its affiliates in the insolvency proceedings only if the receivables fall within the doctrine of fraudulent preference of voidable transfer referred to above.

Also in cases of securitisation, if the documentation for the sale of receivables is defective and does not satisfy the “true sale” criteria prescribed under the guidelines issued by the RBI, the receivables can be added back to the books of the seller for the purposes of computation of the assets of the seller. However, assets of the purchaser cannot be consolidated with assets of the seller.

6.5 Effect of Proceedings on Future Receivables. What is the effect of the initiation of insolvency proceedings on (a) sales of receivables that have not yet occurred or (b) on sales of receivables that have not yet come into existence?

The sale of receivables which were not in existence at the time when the sale was made, such as receivables for the services to be rendered or receivables for goods to be sold in future, can be challenged because it is dependent on performance by the seller, which may not be possible after the liquidation of the seller and, therefore, would not be bankruptcy remote and would vitiate true sale.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in India establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes. The government of India enacted the Securitisation Act, namely, the Securitisation & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 (Securitisation Act). Chapter II of the Act, which is most relevant for us, deals with securitisation.

Basic concepts:

The Securitisation Act deals with the acquisition of financial assets (receivables) by a securitisation company (to be incorporated with the prescribed level of capital) and also deals with enforcement of security by secured creditors. The Securitisation Act provides for the acquisition and can also take place by entering into an agreement for the transfer of the financial assets on terms and conditions agreed between the parties. However, the Act does not specify the mode of assignment of the financial asset to the securitisation company.

The Securitisation Act confers power on the Reserve Bank of India to determine policy and formulate guidelines with respect to securitisation. Any dispute arising between any of the parties to a securitisation transaction are to be settled by arbitration or conciliation as per the provisions of the Arbitration and Conciliation Act, 1996.

The Reserve Bank of India has issued Guidelines to be followed by banks and non-banking finance companies in order to qualify the transaction as a true sale. The main features of the Guidelines include the following:

(i) True sale: To enable the transferred assets to be removed from the balance sheet of the originator in a securitisation structure, the isolation of assets or ‘true sale’ from the originator/seller to the SPV/buyer is an essential prerequisite. Once this is done, the originator/seller (if a bank or a company registered with the Reserve Bank as a non-banking finance company) will not be required to maintain any capital against the value of assets so transferred from the date of such transfer. The Guidelines prescribed a minimum holding period and a minimum retention requirement by the seller in order for the transaction to qualify as a “true sale” under the Guidelines.
(ii) The guidelines provide various criteria that have to be satisfied to meet a true sale including the requirement that the transaction should be bankruptcy remote.

(iii) SPV: This is dealt with under the question 7.2.

(iv) The Guidelines also prescribe the levels and forms of credit enhancements.

(v) Credit enhancement in the form of credit support provided to an SPV to cover the losses on account of default in payments arising in the pool of assets. The Guidelines provide that such facilities can be provided either by the originator and/or third parties.

(vi) The RBI Guidelines also provide for the representations that the seller is required to make.

7.2 Securitisation Entities. Does India have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes. The SARFAESI Act has been specifically enacted to encourage the establishment and regulation of securitisation entities.

The requirements to establish a securitisation company are as follows:

Financial

The securitisation company has to be capitalised up to the limit prescribed under the Act.

The RBI has to be satisfied that the securitisation company has not incurred losses in any of the three preceding financial years and the securitisation company is required to make adequate arrangements for the realisation of the financial assets acquired for securitisation and shall be able to pay periodical returns and redeem on the respective due dates on the investments made in the securitisation company by qualified institutional buyers.

Directors

The RBI may require that the directors of the securitisation company have adequate professional experience in matters related to finance, securitisation and reconstruction. The directors nominated by a sponsor or anyway related with the sponsor or its subsidiaries cannot be more than 50 per cent of the total members of the Board of Directors. The directors shall have been convicted of any offence involving moral turpitude.

Sponsor

The sponsor cannot be a holding company of another securitisation company or otherwise hold any controlling interest in the securitisation company.

Other conditions

(a) Apart from the above, it is also required that the securitisation company complies with the prudential norms specified by RBI.

(b) Yes. There are prescribed attributes and benefits of the company which, inter alia, include the following:

As per the guidelines, the SPV is required to be a bankruptcy remote and non-discretionary structure so as to ensure the passing on of the receivables without any hindrances.

The originator does not have a right to exercise any control, either directly or indirectly, over the SPV and the trustees, and shall not settle the trust deed.

In order to protect their interests, investors are empowered in the trust deed to change the trustee of the SPV at any point of time.

A securitisation company is allowed to perform several other functions provided that performance of these functions by the securitisation company does not give rise to any pecuniary liability on the securitisation company.

(c) Yes. These have been discussed under the requirements for registration as a securitisation company under part (a) of this question.

7.3 Non-Recourse Clause. Will a Court in India give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Yes. The courts in India would recognise a sale to be complete, if it can be established that the contract was a non-recourse transaction. The courts will give effect to the same, but if there is a relation to India (i.e. in the form of either party residing in India, or receivables arising in India), the court will examine the sale from an Indian legal angle. With respect to banks and financial institutions it will be necessary that the sale contract is made subject to the Guidelines.

7.4 Non-Petition Clause. Will a Court in India give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking a legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Indian courts will give effect to a contractual provision so long as it is not in violation of Indian law.

7.5 Priority of Payments “Waterfall”. Will a court in India give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, however a statutory claimant (viz. the tax, stamp duty, etc.) will always enjoy priority. If the company is undergoing liquidation or is facing winding proceedings there are prescribed priorities under the law.

7.6 Independent Director. Will a court in India give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Yes, so long as such provision does not conflict with Indian laws, it would be given effect to by the Indian courts.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in India, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in India? Does the answer to the preceding question change if the purchaser does business with other sellers in India?

If such acquisition is a regular business then it will be necessary to obtain a licence to operate as a non-banking finance company in India. Only a qualified institutional buyer i.e. a financial institution, insurance company, bank, state financial corporation, state industrial development corporation, trustee or securitisation company or a reconstruction company, registered under the Securitisation Act or an asset management company of a mutual fund or a foreign institutional investor are entitled to purchase security receipts issued by a securitisation company.

The position is the same even if the purchaser deals with other sellers.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The servicer does not require a licence but has to be conferred with such rights under a duly signed agreement. However, if receivables arise from a loan transaction, the seller should have had the licence when the loans were given.

8.3 Data Protection. Does India have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Bankers are subject to a requirement to maintain confidentiality with respect to its customers. Further, in some cases there may be a requirement for such obligations for confidentiality even in contracts and the parties to the contract will be bound by the same.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law in India? Briefly, what is required?

Yes, because upon the assignment/sale the purchaser would be bound by the obligations arising under the contract with the obligors. If the purchaser is a bank and is trading in consumer receivables, the consumer protection law will apply to the purchaser in its capacity as the assignee of the rights and obligations of the assignor.

8.5 Currency Restrictions. Does India have laws restricting the exchange of Indian currency for other currencies or the making of payments in Indian currency to persons outside the country?

Yes. Inflow and outflow of exchange is strictly regulated in India. The law governing foreign exchange transactions is the Foreign Exchange Management Act, 1999 and the rules and regulations made thereunder (‘FEMA’), which restricts not only exchange of Indian Rupees for other currencies but also payments in Indian currency to persons resident outside India.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in India? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

If the receivables consist of an interest element, then the question of withholding tax would arise. However, if the payment is of a principal amount such as a hire purchase instalment or repayment of loan instalments, there will not be any withholding tax.

9.2 Seller Tax Accounting. Does India require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No specific accounting policies have, so far, been prescribed for tax purposes, whether by the purchaser or the seller in the context of securitisation. Accounts are to be prepared as per Indian generally accepted accounting principles.

9.3 Stamp Duty, etc. Does India impose stamp duty or other documentary taxes on sales of receivables?

Yes, in India, as per Indian law, there is a stamp duty implication on transactions. Stamp duty is also payable on every securitisation/assignment document.

9.4 Value Added Taxes. Does India impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

No. There is no value added tax but there is service tax on any services offered for consideration.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Yes, if the seller avoids paying taxes arising on account of the sale of assets, and the assignor fails to pay the taxes as and when due, the obligation would then flow to the assignee/purchaser.

The stamp authorities will recover stamp duties from any of the parties, if the stamp duty is not paid on a document. Accordingly, the stamp duty authorities will be able to make a claim against the purchaser for stamp duty payable on assignment of receivables or collection for unpaid tax.
9.6 Doing Business. Assuming that the purchaser conducts no other business in India, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in India?

The purchaser will be taxed for its income in India. Also, if it conducts its business on a regular course of activities in India, whether through an agent or otherwise, the purchaser will be liable to pay tax on income, if any, arising from the sale/resale of the receivables or on the differential amount between the amount paid for purchase of the receivables or the amount of the receivables actually received by it. Whether such tax will be as applicable on a business income or on capital gains will depend on the nature of the business of the purchaser.

Dave & Girish & Co. was founded in the year 1978 and is a pioneer in the field of securitisation. The firm has offices in Mumbai and Bangalore and associate offices in Delhi and Hyderabad. Dave & Girish is known for its cross-border banking, international finance and corporate law practices. Dave & Girish & Co. was the first law firm to have become a member of the International Swaps and Dealers Association and it was also the first firm to document a securitisation transaction in India. It aces the field of structured finance and derivatives and is known for its skills in drafting and documenting and negotiating intricate financing documentation. The firm represents multinational banks and major corporate groups in India.

The firm was started by Late Mohanlal Dave and is currently headed by Mr. Girish Dave who is a luminary in the field of banking and corporate law. His latest transactions include an offshore syndicated loan and a Japanese Bond Issue.

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Chapter 21

Ireland

A&L Goodbody

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

To be enforceable against the obligor a debt obligation need not be evidenced by a formal written contract, but must be evidenced as a matter of contract or deed. Contracts may be written, oral or partly written and partly oral. An invoice could either itself constitute the contract between the seller and obligor if the standard elements of a contract are present. Where a contract is oral, evidence of the parties’ conduct may be used in determining the terms of the contract. A contract may also be implied based on a course of conduct or dealings between the parties.

1.2 Consumer Protections. Do Irish laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Consumer credit agreements are regulated by the Consumer Credit Act 1995 (as amended) (the CCA) and the European Communities (Consumer Credit Agreements) Regulations 2010 (as amended) (the CCA Regulations).

There is no statutory interest rate cap but under the CCA if the cost of credit under a credit agreement is excessive it may be unenforceable.

There is no statutory right to interest on late payments, but contractual “default interest” may be imposed (as long as it does not constitute a penalty).

If a consumer credit agreement does not comply with the requirements of the CCA, the creditor will not be able to enforce it. Certain clauses in a receivables contract with a consumer could be also found to be unfair under the European Communities (Unfair Terms in Consumer Contracts) Regulations 1995 (the UTCCR Regulations) and hence unenforceable.

The Consumer Protection Code (the CPC) of the Central Bank of Ireland (the CBI) also imposes obligations on “regulated entities” in their dealings with their “customers”. The Consumer Protection Act 2007 contains a general prohibition on unfair, misleading, aggressive and prohibited trading practices that could result in a contract with a consumer being rendered void or unenforceable.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Under the Prompt Payments of Accounts Act 1997, all Irish public bodies and contractors on public sector contracts must pay amounts due to their suppliers promptly (i.e. on or before the due date in the contract or if there is no due date (or no written contract) within 45 days of receipt of the invoice or delivery of the global servicers).

In certain circumstances, enforceability of receivables contracts with the government/a government agency could potentially be an issue as a result of the law of sovereign immunity.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Ireland that will determine the governing law of the contract?

Contracts entered into on, or after, 17 December 2009, will be governed by Regulation (EC) 593/2008 of 17 June 2008 (Rome I). Contracts entered into prior to 17 December 2009 will be subject to the Contractual Obligations (Applicable Law) Act 1991, pursuant to which the Rome Convention on the Law Applicable to Contractual Obligations (the Rome Convention) was enacted in Ireland.

Under Rome I, in the absence of an express choice of law in a contract, the applicable law of the contract will be that of the country with which it has the “closest connection” which is the country where the party who is to perform the contract has its habitual residence or its central administration (unless the contract is within one of a number of defined classes for which specific rules apply or is manifestly more closely connected with the law of a different country or if it is sufficiently certain from the terms or circumstances of the contract which law the parties intended to apply).

Under the Rome Convention the applicable law of a contract is presumed to be that of the country with which it has the “closest connection” (i.e. the country where the party performing the contract has his habitual residence or its central administration). However, if the contract is a commercial or professional contract,
the applicable law will be the law of the place in which the principal place of business of the party performing the contract is situated or, where performance is to be effected through a place of business other than the principal place of business of that party, the country in which that other place of business is situated.

If the contract falls outside the scope of Rome I or the Rome Convention, Irish common law principles will determine the applicable law by reference to the parties’ intentions. If the parties’ intention cannot be established, the applicable law will be the law with which the contract has its closest and most real connection.

2.2 Base Case. If the seller and the obligor are both resident in Ireland, and the transactions giving rise to the receivables and the payment of the receivables take place in Ireland, and the seller and the obligor choose the law of Ireland to govern the receivables contract, is there any reason why a court in Ireland would not give effect to their choice of law?

In those circumstances the Irish courts should give effect to the choice of Irish law.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Ireland but the obligor is not, or if the obligor is resident in Ireland but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Ireland give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

As discussed above, Rome I and the Rome Convention provide that the parties to a contract may freely choose the law of their contract and that choice is generally only overridden if it conflicts with mandatory rules or public policy. Contracts falling outside the scope of Rome I or the Rome Convention will be subject to standard Irish common law principles which also generally support the parties’ choice of law and will only displace that choice in exceptional circumstances.


No, it is not.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Irish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Irish laws or foreign laws)?

Irish law does not require the sale of receivables to be governed by the law governing the receivables themselves. Whether under Rome I, the Rome Convention or principles of common law, subject to certain exceptions, the parties to a contract can choose the law of any country to govern the contract irrespective of the law governing the receivable.

However, whether a receivable has been validly sold and whether such sale has been perfected will generally be a matter for the law governing the receivable and not the law governing the receivables purchase agreement. Furthermore, the enforceability of the receivables against the obligor may be determined by the law of the jurisdiction in which the obligor is located.

3.2 Example 1: If (a) the seller and the obligor are located in Ireland, (b) the receivable is governed by the law of Ireland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Ireland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Ireland, will a court in Ireland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, it should.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Ireland, will a court in Ireland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

See section 2 and question 3.1 above. In addition, under Rome I and the Rome Convention, laws other than the governing law of the receivables purchase agreement may sometimes be taken into account. For instance, where a contract is governed by Irish law but will be performed in a place other than Ireland, the Irish courts might apply certain mandatory provisions of the law of the country where the contract is to be performed (if the contract would otherwise be rendered unlawful in that country).

3.4 Example 3: If (a) the seller is located in Ireland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Ireland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Irish own sale requirements?

As per section 2, question 3.1 and question 3.3 above, under Rome I and the Rome Convention where there is an express choice of law by the parties to a contract, the Irish courts should recognise the choice of law and assess the validity of the contract in accordance with the law chosen by the parties.

However, certain mandatory principles of Irish law cannot be disappplied and the courts might not apply the parties’ chosen law to the extent it conflicted with those mandatory principles.
3.5 Example 4: If (a) the obligor is located in Ireland but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Ireland recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Irish own sale requirements?

Yes. See section 2 and questions 3.1, 3.3 and 3.4 above.

3.6 Example 5: If (a) the seller is located in Ireland (irrespective of the obligor’s location), (b) the receivable is governed by the law of Ireland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Ireland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Ireland and any third party creditor or insolvency administrator of any such obligor)?

Yes. See section 2 and questions 3.1, 3.3, 3.4 and 3.5 above.

4 Asset Sales

4.1 Sale Methods Generally. In Ireland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

In Ireland receivables are most commonly sold by way of legal (or equitable) assignment. Other methods which are more rarely used include: a declaration of trust over the receivables (or over the proceeds of the receivables); a sub-participation; or a novation. An outright sale of receivables may be described as a “sale”, a “transfer” or an “assignment”, although “assignment” often indicates a transfer of the rights in respect of the receivables (and not the obligations), while a “transfer” often indicates a transfer of both rights and obligations by way of novation. The phrase “security assignment” is often used to distinguish a transfer by way of security from an outright assignment.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

A sale of receivables by way of an outright legal assignment is perfected by the delivery of notice in writing of the sale to the obligor(s) of the relevant receivables of the receivables in accordance with the requirements of Section 28(6) of the Supreme Court of Judicature (Ireland) Act 1877 (the Judicature Act). The provision of notice does not, of itself, result in the transfer becoming a legal (as opposed to an equitable) assignment as certain other formalities are also required, namely (i) the assignment must be in writing under the hand of the assignor, (ii) it must be of the whole of the debt, and (iii) it must be absolute and not by way of charge. If the assignment does not fulfil all these requirements, it will likely take effect as an equitable assignment so that any subsequent assignment effected by the seller which is fully compliant with the Judicature Act requirements will take priority over the prior assignment.

A novation of receivables (i.e., of both the rights and obligations in respect of such receivables) requires the written consent of the obligor(s) of the receivables (which would be effective against all good faith purchasers for value of the same receivables from the seller).

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The transfer requirements for promissory notes (as well as other negotiable instruments) are governed by the Bills of Exchange Act 1882, which provides that they are transferable by delivery (or delivery and endorsement).

Mortgage loans and their related mortgages may be transferred by way of assignment. For a mortgage over real property in order to effect a full legal (rather than just equitable) assignment, the transfer will need to be registered at the Land Registry or the Registry of Deeds (whether the land is registered or unregistered).

Most residential mortgage-backed securitisation transactions are structured as an equitable assignment of mortgage loans and their related mortgages to avoid giving notice to the underlying mortgagors and registering the transfer. Until the CBI’s Code of Conduct on the Transfer of Mortgages, a loan secured by a mortgage of residential property may not be transferred without the written consent of the borrower (the relevant consent is usually obtained from the mortgage origination documentation).

Questions 8.3 and 8.4 below outline some of the regulatory requirements in relation to consumer loans. Under the CCA Regulations, a consumer must be provided with notice of any transfer by the creditor of its loan, except where the original creditor continues to service the credit. Under the CPC where part of a regulated business is transferred by a regulated entity (including a transfer of consumer loans) at least two months’ notice must be provided to affected consumers if the transferee is another regulated entity (and one month if it is not).

 Marketable debt securities in bearer form, may be transferred by delivery and endorsement; in registered form, by registration of the transferee in the relevant register. Dematerialised marketable securities may be transferred by debiting the clearing system account of the purchaser (or its custodian or nominee/intermediary).

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

A seller or purchaser need not notify the obligors to effect a valid equitable sale of the receivables (which would be effective against the obligors).
the seller). However, in order for a legal sale of the receivables to be effected (enforceable against both the seller and the underlying obligor) notice would need to be provided.

The obligors’ consent is not required for the sale to be effective against them. In the absence of an express contractual prohibition on assignment, receivables may be assigned without the obligor’s consent. If there is a contractual prohibition on assignment, other methods of transfer may be available (see question 4.1 above) depending on the precise wording of the contract.

If notice is not provided: (i) obligors can discharge their debts by paying the seller; (ii) obligors may set-off claims against the seller even if they accrue after the assignment; (iii) a subsequent assignee without notice of the prior assignment would take priority over the claims of the initial purchaser; and (iv) the purchaser cannot sue the obligor in its own name, but must join the seller as co-plaintiff.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Notice must be in writing and given to the obligor at the time of, or after, the sale (preferably after), but there is no particular form specified. The notice should clearly state that the obligor must pay the assignee (the purchaser) going forward.

There is no specific time limit for the giving of notices set down in the Judicature Act and notice can be given to obligors post-insolvency of the obligor or the seller (including pursuant to an irrevocable power of attorney granted by the seller). The notice should only apply to specific receivables.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Ireland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Ireland recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on assignment or transfers are generally enforceable. If a contract is silent on the question of assignment, then a contract (and the receivables arising thereunder) will be freely assignable. If an assignment is effected in breach of a contractual prohibition on assignment it will be ineffective as between the obligor and the seller, but should be effective as between the seller and purchaser.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to have objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must specify the receivables being sold with sufficient clarity that they are identifiable and distinguishable from the rest of the seller’s assets. The receivables being sold need not share objective characteristics but normally a portfolio of receivables being sold is all of the same type. To our knowledge, the scenario has not been considered by the Irish courts but a purported sale of all of a seller’s receivables other than those owing by specifically identified obligors might be effective if the contract sufficiently identifies the receivables not being sold.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intention that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

If a transaction is expressed to be a sale and the sale agreement (and other documents) purport to effect a sale but this does not reflect the actual agreement between the parties, the purported sale could be recharacterised as a secured loan. Irrespective of the label given to a transaction by the parties, the court will look at its substance (including the particular economic characteristics of the transaction) and will examine whether it creates rights and obligations consistent with a sale.

English case law (which is only of persuasive authority in the Irish courts and is not binding on them) has established a number of key questions which must be considered when determining whether a transaction is a sale rather than a secured loan:

(i) Is the transaction a “sham”? (i.e. do the transaction documents accurately reflect the intention of the parties or is there some other agreement or agreements that constitute the real transaction between the parties?)

(ii) Does the seller have the right to reacquire the receivables?

(iii) Does the purchaser have to account for any profit made by it on the sale of the receivables?

(iv) Is the seller required to compensate the purchaser if it ultimately realises the acquired receivables for an amount less than the amount paid?

Although it will depend on the particular circumstances, the fact that the seller remains as servicer/collection agent of the receivables post-sale, or retains some degree of credit risk in respect of the receivables post-sale, is not considered to be inconsistent with the transfer being treated as a sale (rather than a secured loan).

There is no Irish case law on the point, but a right of repurchase/redemption for the seller would likely be inconsistent with the transaction being one of true sale. However, if the seller has only a right to ask the purchaser to sell the receivables back, such an arrangement might not be inconsistent with a true sale.
If the sale is recharacterised as a secured loan, the assets “sold” will remain on the seller’s balance sheet and the loan will be shown as a liability of the seller. In addition, as it is not the practice in Ireland to make “back-up” security filings, the security may not have been registered and may be void in an insolvency of the seller for lack of registration.

In addition to recharacterisation, sale transactions are also vulnerable under certain provisions of the Irish Companies Acts 1963 to 2012 (the Companies Acts) such as Section 139 of the Companies Act 1990 (improper transfers of company assets) and Section 286 of the Companies Act 1963 (fraudulent preferences).

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes. However, the sale of the receivables would need to be by way of an equitable assignment (an agreement whereby a seller purports to sell receivables on a continuous basis will generally take effect as an agreement to assign); the receivables will then be automatically equitably assigned as, and when, they come into existence.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Yes. See question 4.9 above – an assignment of a receivable not in existence at the time of the agreement, but which will be ascertainable in the future, is treated as an agreement to assign and should give rise to an equitable assignment as soon as the receivable comes into existence. See question 6.5 for the effect the seller’s insolvency could have on such an agreement to assign.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Related security will typically be capable of being assigned in the same manner as the receivables themselves. The transfer or assignment of certain types of security may require additional formalities (some of which are referred to in question 4.3 above).

5 Security Issues

5.1 Back-up Security. Is it customary in Ireland to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary in Ireland to take such a “back-up” security when the intention is to effect an outright sale of the relevant receivable.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Ireland, and for such security interest to be perfected?

See question 5.3 (below).

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Ireland to grant and perfect a security interest in purchased receivables governed by the laws of Ireland and the related security?

Security is most commonly taken over receivables by way of a legal (or equitable) assignment or a charge over book debts.

Receivables assigned by way of security will create a mortgage over the receivables, either legal (if the requirements of the Judicature Act are followed – see question 4.2 above) or (in the absence of these requirements) equitable. Prior to the perfection of an equitable mortgage by notice to the obligor, the assignee’s security will be subject to prior equities (such as rights of set-off and other defences), and will rank behind a later assignment (where the later assignee has no notice of the earlier assignment and has itself given notice to the obligor). In addition, the obligor will be able to discharge its debt by continuing to pay the assignor (as described in questions 4.4 and 4.5).

Alternatively, a fixed or floating charge could be granted over the receivables. In comparison to a mortgage (which is a transfer of title together with a condition for re-assignment on redemption), a charge is a mere encumbrance on the receivables, giving the chargee a preferential right to payment out of the receivables in priority to other creditors of the relevant company.

A fixed charge is typically granted over specific receivables and attaches to those receivables upon the creation of the fixed charge. In comparison, a floating charge is normally granted over a class of assets (both present and future) which, prior to the occurrence of a “crystallisation event”, can continue to be managed in the ordinary course of the chargor’s business. On the occurrence of a crystallisation event, the floating charge will attach to the particular class of the chargor’s assets, effectively becoming a fixed charge over those assets. If the Irish courts are asked to determine whether a security interest is a fixed charge or a floating charge they will look at the substance of the security created rather than how it is described or named. The extent to which the chargor can exercise control over the receivables without the chargee’s consent will often be an important factor in the court’s determination.

In terms of perfection, if an Irish company grants security over certain types of assets (including receivables constituting book debts) (i.e. it creates a “registrable charge” for the purposes of the Companies Acts), it must register short particulars of the security created with the Irish Registrar of Companies within 21 days of its creation.

The European Communities (Financial Collateral Arrangements) Regulation 2004 (as amended) and the European Communities (Financial Collateral Arrangements) Regulations 2010 (as amended) (together, the Financial Collateral Regulations) provide that security over “financial collateral” (cash, financial instruments and credit claims) that constitutes a “security financial collateral arrangement”, although it constitutes a registrable security interest under the Companies Acts does not need to be registered with the Registrar of Companies. However, it is still customary to register these charges.

Failure to register a registrable security interest within 21 days of its creation will result in that security interest being void as against the liquidator and any creditors of the company which created the
registrable charge. However, an unregistered charge will still be valid as against the chargor, provided the chargor is not in liquidation.

Registration of a charge under the Companies Act does not determine priority so that, provided both charges are registered within the 21-day period after creation, a prior created charge will take priority over a subsequently created charge even where that later charge is registered first.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Ireland, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Ireland or must additional steps be taken in Ireland?

The relevant security must be valid and perfected under the laws of Ireland and under the governing law of the security, in order for it to be given effect by the Irish courts. Accordingly, if the security over the receivables is created by a purchaser which is an Irish company or by a foreign company and the receivables are situated in Ireland, details of the security will generally need to be filed with the Registrar of Companies within 21 days of its creation (see question 5.3 above).

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

A security assignment is usually taken over insurance policies. Security over mortgage or consumer loans will be created by mortgage or charge. An equitable mortgage is typically created over the mortgage securing a mortgage loan.

The type of security over marketable debt securities depends on whether the relevant securities are bearer or registered, certificated, immobilised or dematerialised and/or directly-held or indirectly-held: (i) directly-held and certificated debt securities, where registered, are generally secured by legal mortgage (by entry of the mortgagee on the relevant register) or by equitable mortgage or charge (by security transfer or by agreement for transfer or charge); (ii) security over bearer securities may be created by mortgage or pledge (by delivery together with a memorandum of deposit) or charge (by agreement to charge); and (iii) security may be created over indirectly-held certificated debt securities by legal mortgage (by transfer, either to an account of the mortgagee at the same intermediary or by transfer to the mortgagee’s intermediary or nominee via a common intermediary) or by equitable mortgage or charge (by agreement of the intermediary to operate a relevant securities account in the name of the mortgagor containing the debt securities to the order/control of the chargee).

The security interests described above may be registrable with the Registrar of Companies under the Companies Acts. If the security interest contributes a “security financial collateral arrangement” the Financial Collateral Regulations may apply (see question 5.3 above).

5.6 Trusts. Does Ireland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Ireland recognises trusts and a trust over collections received by the seller in respect of sold receivables should be recognised under the laws of Ireland (provided it is validly constituted).

5.7 Bank Accounts. Does Ireland recognise escrow accounts? Can security be taken over a bank account located in Ireland? If so, what is the typical method? Would courts in Ireland recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Ireland?

Ireland recognises the concept of money held in escrow in a bank account. Security may be taken over a bank account in Ireland and is typically taken by way of a charge or security assignment. Security over an overdraft balance granted by a depositor in favour of the bank at which such deposit is held can only be achieved by way of charge (not by assignment). If the security constitutes a “security financial collateral arrangement” over “financial collateral” within the meaning of the Financial Collateral Regulations, then those regulations should apply (as to which, see question 5.3 above).

Foreign-law governed security over an Irish situate bank account must be valid under both Irish law and the foreign law in order for it to be given effect by the Irish courts (see question 5.4 above).

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Normally notice of the creation of security over the account is provided to the bank with which the account is held, and an acknowledgment sought that the bank will, inter alia, (upon notification that the security has become enforceable) act in accordance with the instructions of the secured party. So if such an acknowledgment has been obtained, once the secured party enforces its security over the relevant bank account, the bank should follow its instructions in respect of the cash in (or flowing into) the account until the obligations owed to the secured party are discharged in full.

However, this control is conferred on the secured party by contract – the bank could refuse to act in accordance with the secured party’s instructions. Furthermore, rights of set-off (under statute, common law or contract) might be exercisable in respect of the cash in the account to the detriment of the secured party. Finally, under Irish banking crisis resolution legislation the CBI and the Minister for Finance have powers to direct the activities of Irish credit institutions in certain circumstances, and the exercise of such powers could interfere with the secured party’s control over the bank account.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

This depends on the type of security granted over the account/account balance. If a floating charge is granted, the fact the owner of the account may access funds in the account should not affect the validity of the floating charge. However, if the security granted purports to be a fixed charge, the more freely the owner can access the funds in the account the less likely the charge would actually be treated as a fixed charge and the more likely it would be recharacterised as being a floating charge.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Irish insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

The appointment of a liquidator or an examiner to an insolvent Irish company imposes an automatic stay of action against the entity, but if the receivables have been transferred by legal assignment, the sale will have already been perfected, and the stay should not affect the purchaser’s ability to enforce its rights in the receivables. If the seller has been appointed as the servicer of the receivables, the stay of action could block the purchaser from enforcing the servicing contract, and any amounts held by the servicer in respect of the receivables (other than if not held on trust for the purchaser under a valid and binding trust arrangement) could be deemed to form part of the insolvency estate of the servicer, and rather than being the property of the purchaser, if only an equitable assignment has been effected (i.e. no notice has been given to an obligor), an obligor may continue to pay the seller. Normally, the seller will hold any such amounts on trust for the purchaser, but if no such trust has been created, such amounts will likely form part of the seller’s insolvency estate and the purchaser would be an unsecured creditor of the seller in respect of those amounts.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of its rights (by means of injunction, stay order or other action)?

See question 6.1 above. Assuming the receivables have been sold by legal assignment or by means of a subsequently perfected equitable assignment, an Irish insolvency official appointed over the seller should not be able to prohibit the purchaser’s exercise of its rights (unless there has been a fraudulent preference or an improper transfer of company assets, as described below).

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Ireland for (a) transactions between unrelated parties and (b) transactions between related parties?

Under Section 139 of the Companies Act 1990, if a liquidator can show that any company property was disposed of and the effect was to “perpetrate a fraud” on either the company, its creditors or its members, the High Court may, if just and equitable, order any person who appears to have “use, control or possession” of the property or proceeds of the sale or development thereof, to deliver it or pay a sum in respect of it to the liquidator on such terms as the High Court sees fit.

Section 286 of the Companies Act, 1963 (as amended) provides that any conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company, which is unable to pay its debts as they become due to any creditor, within six months of the commencement of a winding up of the company with a view to giving such creditor (or any surety or guarantor of the debt due to such creditor) a preference over its other creditors, will be invalid. Case law indicates that a “dominant intent” must be shown on the part of the entity concerned to prefer a creditor over other creditors. Furthermore, Section 286 is only applicable if at the time of the conveyance, mortgage or other relevant act, the company was already insolvent. Where the conveyance, mortgage etc. is in favour of a “connected person”, the six-month period is extended to two years.

Section 288 of the Companies Act, 1963 (as amended) renders invalid (except to the extent of monies actually advanced or paid or the actual price or value of the goods or services sold or supplied to the company at the time of or subsequently to the creation of the charge, together with interest on that amount at the rate of 5 per cent per annum) floating charges on the property of a company created within 12 months before the commencement of the winding up of that company (unless the company was solvent immediately after the creation of the charge). Where the floating charge is created in favour of a “connected person”, the 12-month period is extended to two years.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Irish law gives an Irish court the power, in certain circumstances, to treat the assets and liabilities of one company as though they were assets and liabilities of any other.

An Irish court may exercise its equitable jurisdiction and treat two or more companies as a single entity if this conforms to the economic and commercial realities of the situation and the justice of the case so requires. Furthermore, if an Irish company goes into liquidation or examination, the Companies Acts specify particular scenarios where an Irish court has the power to “make such order as it thinks fit” in respect of transactions entered into by that company to restore the position to what it would have been if it had not entered into the transaction. In addition, in certain limited instances, a court may “pierce the corporate veil”.

Also, depending on the particular case, a court may (i) order that the appointment of an examiner to a company be extended to a “related company” of the company in examination, (ii) (if it is just and equitable to do so) order that any related company of a company being liquidated pay some or all of the debts of the company in liquidation (a “contribution order”), or (iii) provide that where two or more “related companies” are being wound up (and it is just and equitable to do so), both companies be wound up together as if they were one company (a “pooling order”).

However, case law suggests that the above powers/orders will only be exercised/granted in exceptional circumstances.
6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Ireland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

If a true sale of the receivables (including future receivables) has already been effected, the purchase price for the receivables has been paid (subject to the matters described in questions 6.1 and 6.3 above), and no further action is required by the seller, the seller’s insolvency should not of itself affect the purchaser’s rights as purchaser of the receivable.

If a receivables purchase agreement has been entered into, but the purchase price is not paid prior to the seller’s insolvency, the purchaser will be left as an unsecured creditor of the seller.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Ireland establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes. Section 110 of the Taxes Consolidation Act, 1997 (the TCA) allows for the special treatment of Irish companies (Section 110 SPVs) under which securitisations and other structured transactions can be effected. Section 110 SPVs are normal Irish private limited companies incorporated under the Companies Acts which, if they meet the conditions set out in Section 110, have their profits calculated for Irish tax purposes as if they were carrying on a trade.

This enables them to take deductions for all expenditure, in particular, interest payments that must be made on the debt instruments issued by them. This ensures that there is very little or no Irish tax payable by Section 110 SPVs. This legislative regime has facilitated the development of securitisation in Ireland and Section 110 SPVs have been used in numerous cross-border securitisations.

There are also generous exemptions available from Irish withholding tax on payments of interest made by Section 110 SPVs which are structured to fall within the securitisation legislation. (These are discussed in more detail in question 9.1.) One clear advantage for Section 110 SPVs is that they can make payments of “profit dependent” interest without any negative implications and can use straight “pass through” structures, for example, collateralised debt obligations.

In order to avail of the relief under Section 110, the company must be a “qualifying company” i.e. it must:
(a) be resident in Ireland;
(b) acquire “qualifying assets”;
(c) carry on in Ireland a business of holding, managing, or both the holding and management of, qualifying assets;
(d) apart from activities ancillary to that business, carry on no other activities;
(e) the market value of the qualifying assets, is not less than €10 million on the day on which they are first acquired; and
(f) have notified the Revenue Commissioners that it is, or intends to be, a Section 110 company.

A company shall not be a qualifying company if any transaction or arrangement is entered into by it otherwise than by way of a bargain made at arm’s length.

The definition of “qualifying assets” is non-exhaustive and includes shares, bonds, receivables, other securities, futures, etc.

7.2 Securitisation Entities. Does Ireland have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Irish law does not specifically provide for the establishment of special purpose entities for securitisation transactions, but see the answer to question 7.1 above.

7.3 Non-Recourse Clause. Will a court in Ireland give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

A contractual provision limiting the recourse of the creditors of an entity to its available funds is likely to be valid under Irish law (whether the contract’s governing law is Irish or the law of another country).

7.4 Non-Petition Clause. Will a court in Ireland give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Although there is little authority in Irish law, it is likely that an Irish court would give effect to contractual provisions (whether governed by Irish law or the law of another country) prohibiting the parties to the relevant contract from taking legal action (or commencing an insolvency proceeding) against the purchaser or another person.

It is possible that an Irish court would consider an insolvency winding-up petition even if it were presented in breach of a non-petition clause. A party may have statutory or constitutional rights to take legal action against the purchaser/another person, which may not be contractually disapplied and a court could hold that the non-petition clause was contrary to Irish public policy on the grounds referred to above (i.e., ousting of court jurisdiction and/or Irish insolvency laws).

7.5 Priority of Payments “Waterfall”. Will a court in Ireland give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

An Irish court should generally give effect to a contractual provision (whether the contract’s governing law is Irish or the law of another country) distributing payments to an Irish company’s creditors in a certain order. However, in an insolvency of an Irish company certain creditors are given preferential status by statute and so the contractual priority of payments provision could be altered.
7.6 Independent Director. Will a court in Ireland give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an Insolvency proceeding) without the affirmative vote of an independent director?

An Irish court should give effect to such a provision or article in an Irish company’s articles of association.

However, any provision which purports to restrict or limit the directors’ ability to bring insolvency proceedings may be invalid on public policy grounds or as incompatible with the directors’ statutory duties.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Ireland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Ireland? Does the answer to the preceding question change if the purchaser does business with other sellers in Ireland?

If the underlying obligors are consumers the CCA (and the other consumer protection legislation and codes discussed in question 1.2 above and question 8.4 below) may be applicable (irrespective of whether the purchaser is dealing with one or more sellers in Ireland). The CCA provides for the licensing of three categories of activity acting as: (i) a moneylender; (ii) a credit intermediary; or (iii) a mortgage intermediary. In addition, under Irish data protection legislation, the purchaser might need to register with the Irish Data Protection Commissioner as a “data controller” or a “data processor”.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The seller does not need a licence in order to continue to enforce and collect receivables following their sale to the purchaser as debt collection is not a specifically-licensed activity in Ireland. However, with respect to any consumer receivables it continues to service, it would need to comply with applicable Irish consumer protection legislation (e.g., the CPC). The seller would also need to be registered with the Data Protection Commissioner. Where the seller continues to act as servicer with respect to residential mortgage loans, it will need to be authorised to perform such role by the CBI. Any standby or replacement servicer would require the same licences and authorisations.

8.3 Data Protection. Does Ireland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Irish Data Protection Act 1988 and the Irish Data Protection (Amendment) Act 2003 (the DPAs) restrict the use and dissemination of personal data in relation to “data subjects”, which are “individuals” (i.e. natural persons and not corporate entities). The DPAs regulate the collection, processing, use and disclosure of data and provide, inter alia, that such data must be kept for one or more specified and lawful purposes only, that it must be used and disclosed only in ways compatible with those purposes and be kept safe and secure.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Ireland? Briefly, what is required?

If the obligors are “consumers” then a bank acting as a purchaser will need to comply with the terms of its authorisation and the applicable codes of conduct/advertising rules (e.g., the CPC) or other Irish consumer protection laws, including, the CCA, the CCA Regulations and the UTCCR Regulations.

The CCA imposes a number of obligations on credit intermediaries and also provides protections to consumers (e.g., by regulating the advertising of consumer credit, and by bestowing a “cooling-off” period in favour of the consumer after signing an agreement).

The CCA Regulations apply to loans to consumers where the amount lent is between €200 and €75,000. The main provisions of the CCA relate to, inter alia, (i) standardisation of the information to be contained in a credit agreement, (ii) standardisation of pre-contractual information, and (iii) a full 14-day “right of withdrawal” for consumers from the relevant credit agreement.

Where there is a significant imbalance in the parties’ rights and obligations under a consumer contract to the detriment of the consumer, the UTCCR Regulations may apply. The UTCCR Regulations contain a non-exhaustive list of terms which will be deemed “unfair” and the list includes terms which attempt to exclude or limit the legal liability of a seller in the event of the death of or personal injury of a consumer due to an act or omission by the seller, or, require any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation. If a term is unfair it will not be binding on the consumer. However, the contract should continue to bind the parties, if it is capable of continuing in existence without the unfair term.

The CPC imposes general obligations on “regulated entities” dealing with “customers” in Ireland (primarily “consumers”), to act honestly, fairly and professionally, and with due skill, care and diligence in the best interests of their customers and to avoid conflicts of interest.

If there is no obligation on a non-bank purchaser to provide any funding to a consumer, then it should not need to be licensed, but might still need to comply with the CCA, the UTCCR Regulations, the CPC and the CCA Regulations (if applicable).

8.5 Currency Restrictions. Does Ireland have laws restricting the exchange of Irish currency for other currencies or the making of payments in Irish currency to persons outside the country?

Ireland does not have any exchange control laws. Certain financial transfer orders in place from time to time may restrict payments to certain countries, groups and individuals subject to UN sanctions.
9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Ireland? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

It is usually possible to structure a securitisation (especially when using a Section 110 SPV) so that payments on receivables are not subject to Irish withholding tax.

There is a general obligation to withhold tax from any payment of yearly interest made by an Irish company. The rate of withholding is currently 20 per cent. Therefore, in principle, if the debtor is an Irish person and the receivable has a maturity of more than one year it is likely this withholding obligation will arise. Interest paid by Irish debtors to a Section 110 SPV should come within an exemption from interest withholding tax.

Exemptions also exist for interest payments made by a Section 110 SPV. There is an exemption for interest paid by a Section 110 SPV to a person who is resident for the purposes of tax in an EU Member State (other than Ireland) or in a country with which Ireland has a double tax treaty (except in a case where the person is a company where such interest is paid to the company in connection with a trade or a business which is carried on in Ireland by the company through a branch or agency).

There is also an exemption for interest paid on a quoted Eurobond, where either:

(a) the person by, or through, whom the payment is made is not in Ireland i.e. non-Irish paying agent; or
(b) the payment is made by, or through, a person in Ireland, and either:
   (i) the quoted Eurobond is held in a recognised clearing system (Euroclear and Clearstream SA are so recognised); or
   (ii) the person who is a beneficial owner of the quoted Eurobond and who is beneficially entitled to the interest is not resident in Ireland and has made a declaration to this effect.

A quoted Eurobond means a security which is:

(a) issued by a company;
(b) quoted on a recognised stock exchange; and
(c) carries a right to interest.

9.2 Seller Tax Accounting. Does Ireland require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

A company qualifying for the favourable Irish tax treatment provided for by Section 110 of the TCA will be, subject to certain adjustments required by law, subject to Irish corporation tax on its profit according to its profit and loss account prepared in accordance with generally accepted commercial accounting principles in Ireland as at 31 December 2004 (i.e., before the introduction of IFRS), unless it elects otherwise.

9.3 Stamp Duty, etc. Does Ireland impose stamp duty or other documentary taxes on sales of receivables?

An agreement for the sale of, or an instrument effecting the sale of, debt having an Irish legal situs may also be chargeable to Irish stamp duty absent an exemption. An instrument effecting the transfer of debt having a non-Irish situs may also be chargeable to Irish stamp duty, absent an exemption, if it is executed in Ireland or if it relates to something done or to be done in Ireland. There are certain exemptions from Irish stamp duty that may be relevant, such as the debt factoring exemption or loan capital exemption. A transfer by way of novation should not give rise to stamp duty.

9.4 Value Added Taxes. Does Ireland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Ireland does apply VAT on the sale of goods and services. The standard rate of VAT is 23 per cent.

A purchaser will be required to register and account, on a reverse charge basis, for Irish VAT at the rate of 23 per cent on the receipt by it of certain services from persons established outside Ireland. These services would include legal, accounting, consultancy and rating agency services and also financial services to the extent that those financial services are not exempt from Irish VAT.

The sale of receivables should be exempt from VAT. The services of a collection agent would normally be treated as exempt.

Where a purchaser would not be engaged in making VAT taxable supplies in the course of its business, it would not be able to recover VAT (1) payable by it in respect of the receipt of services outlined in the paragraph above, or (2) charged to it by suppliers of VAT taxable services (e.g., the provision of legal, accounting and audit services by Irish providers, the provision of trustee and administration services and collection agent services).

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

It depends on the nature of the VAT charge that arose. If the supply is received from an Irish supplier that should have levied VAT, then unless there is a contractual provision enabling the seller to claim the VAT off the purchaser, the person the Revenue Commissioners would make a claim against would be the seller. However in the case of reverse charge services received from abroad the accountable person would be the purchaser and the Revenue Commissioners could claim against the purchaser. In an arm’s length transaction stamp duty should be for the account of the purchaser only.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Ireland, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Ireland?

Liability to Irish corporation tax may arise if the purchaser were “carrying on a trade” in Ireland. The term “trade” is a case law derived concept and there is no useful statutory definition of the term. However, in general, the purchase, collection and enforcement of the receivable should not be considered as “trading” under Irish law and the purchaser should not incur any Irish tax liabilities.
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Chapter 22

Israel

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) As a general matter, Israel’s Contracts Law (General Part), 1973 (“Contracts Law”) does not require a formal written agreement to create an enforceable obligation. A contract can be created through written, oral or other means (with some exceptions). Nonetheless, Israel’s Consumer Protection Law, 1981 (“Consumer Protection Law”) and certain regulations promulgated thereunder do require, under certain circumstances, a written contract that addresses certain terms of the transaction in order to create an enforceable obligation against debtors. In general, the Consumer Protection Law applies to the provision of goods or services to consumers that purchase them for domestic, personal or family use. In addition, a transaction in real estate, including a mortgage, requires a written contract.

(b) In principle, if a written document is required under applicable consumer protection legislation, a “tax” invoice could suffice, provided that: (i) the invoice details all transaction terms that need to be specified according to the applicable consumer protection legislation; (ii) the invoice was signed by the consumer; and (iii) a copy of the invoice was provided to the consumer.

(c) According to the Contracts Law, if no requirement for a certain form of contract is required by law (e.g. by virtue of consumer protection or real estate legislation) or agreement between the parties, a contract can be entered into by any means, including behaviour of the parties.

1.2 Consumer Protections. Do Israel’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) Israel’s Interest Order (Determination of the Maximal Interest Rate), 1970 (“Interest Order”) promulgated under the Interest Law, 1957 restricts: (i) the interest rate that may be charged on NIS-denominated loans that are linked to the Consumer Price Index; and (ii) the interest rate that may be charged on arrears of such loans. Additionally, the

Regularisation of Ex-Banking Loans Law, 1993 provides that the annual interest rate of credit granted to a non-corporate entity by a non-banking entity shall not exceed the interest rate of the average unlinked credit cost available to the public, as determined monthly by the Bank of Israel, multiplied by a statutory factor.

(b) Israel’s Contracts Law (Remedies for Breach of Contract), 1970 (“Remedies Law”) entitles the injured party to a right to receive damages for late payment in an amount equivalent to the accrued interest from the date that payment was due until the actual payment date. Similarly, the Interest and Linkage Ruling Law, 1961 authorises a court to award interest for any amount payable according to its ruling as of the date upon which the claim arose, or from after that date and until the date of actual payment.

(c) The Consumer Protection Regulations (Transaction Cancelation), 2010, provides that a consumer is entitled to cancel a purchase agreement in accordance with the provisions of the regulations (within two or 14 days, depending on the underlying goods or services), provided that, in the case of goods, the consumer returns the goods with no damages or use by the consumer.

(d) In general, Israel’s consumer protection laws provide consumers with various rights, such as: the right for detailed information regarding the product, service and price; and the right to receive maintenance services. As indicated in our answer to question 1.1 above, the Consumer Protection Law applies to the provision of goods or services to consumers that purchase them for domestic, personal or family use. In addition, the Unified Contracts Law, 1982 (“Unified Contracts Law”) generally authorises the court to void certain depriving provisions in a unified contract – a contract drafted by a party to be used by it with various unspecified (in their numbers and identity) counterparties.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

As a general matter, Israel’s Tenders Duty Law, 1992 (“Tenders Law”) places on the State of Israel or any governmental entity, health maintenance organisation, local authority or religious council a duty to carry out a public tender before entering into an agreement regarding a transaction in goods or land, performance of work or purchase of services. The Tenders Law and the regulations promulgated thereunder provide for certain exemptions from that duty. The Interpretation Law, 1981 defines “goods” as tangible assets that are not land. In principle, any restriction on the sale or
collection of receivables entered into with the government or a government agency would be subject to the provisions of the tender and agreement applicable to such receivables.

### 2 Choice of Law - Receivables Contracts

#### 2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Israel that will determine the governing law of the contract?

Israeli case law teaches that where the parties do not specify a choice of law in their contract, the court will presume the parties’ intention through the relevant circumstances, i.e.: *locus contractus* (place of contract performance); residency of parties; language of contract; etc. Furthermore, in cases where there is more than one possible governing law, Israeli courts will usually prefer applying the law that validates the contract over the law that voids it.

#### 2.2 Base Case. If the seller and the obligor are both resident in Israel, and the transactions giving rise to the receivables and the payment of the receivables take place in Israel, and the seller and the obligor choose the law of Israel to govern the receivables contract, is there any reason why a court in Israel would not give effect to their choice of law?

Consistent with the principle of freedom of contract, Israeli courts will generally respect an express choice of law provision that is contained in a contract. Case law teaches that the court may not give effect to an expressed choice of law provision upon justified extraordinary circumstances. For instance, a governing law provision will not be enforced by Israeli courts if enforcement of such provision will give rise to a result that runs contrary to public policy or will result in injustice. When the choice of law provision appears in a unified contract – a contract that has been drafted by a party to be used by it with unspecified (in their number and identity) counterparties – the Unified Contracts Law presumes that such provision is depriving and therefore can be voided by the court.

#### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Israel but the obligor is not, or if the obligor is resident in Israel but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Israel give effect to the choice of foreign law?

Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Please see our answer to question 2.2 above. Foreign law will not apply to matters considered by the court to be procedural (which can include certain remedy matters). In the case of insolvency of an Israeli party to an agreement, Israeli law will govern insolvency matters (because they are deemed procedural and, possibly, because of public policy). Similarly, the priority of security interests granted by a debtor to creditors will be determined pursuant to Israeli law. However, if an asset that is part of the liquidation estate is a contract, the validity of, and rights under, such contract will generally be governed by the law applicable to such contract.


### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does Israel’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Israel’s laws or foreign laws)?

There is no statutory requirement under Israeli law to apply the same law that governs the receivables to the sale of such receivables.

#### 3.2 Example 1: If (a) the seller and the obligor are located in Israel, (b) the receivable is governed by the law of Israel, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Israel to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Israel, will a court in Israel recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Please see our answers to questions 2.1 and 2.2 above. For substantive matters, the law of the contract is normally determined from a number of criteria, the most important of which is the original intent of the parties to that contract. If an express choice of law provision is contained in a contract, the chosen law will generally act as the law of the contract, given that the provision expresses the joint original intent of the parties. For procedural matters, the law of the forum is the governing law.

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Israel, will a court in Israel recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Please see our answer to question 3.2 above. The country of location of the obligor and/or the purchaser in the example should not affect the effectiveness of the sale against the seller or its creditors.
3.4 Example 3: If (a) the seller is located in Israel but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Israel recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Israel’s own sale requirements?

In the above example, whether a sale took place should be seen as a question of substance, which in turn, should be determined by the law of the contract, and whether a sale was perfected should be seen as a question of procedure, which, in turn, should be governed by Israeli law, as the seller is located in Israel.

3.5 Example 4: If (a) the obligor is located in Israel but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Israel recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Israel’s own sale requirements?

Please see our answer to questions 3.2 and 3.4 above. A court in Israel should recognise the sale in the example as being effective against the obligor and other third parties if the sale is completed and perfected in compliance with the foreign governing law.

3.6 Example 5: If (a) the seller is located in Israel (irrespective of the obligor’s location), (b) the receivable is governed by the law of Israel, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Israel recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Israel and any third party creditor or insolvency administrator of any such obligor)?

Please see our answer to question 3.4 above.

4 Asset Sales

4.1 Sale Methods Generally. In Israel what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

Typically, receivables are sold by assignment. The customary terminology is “assignment” when addressing a change of ownership in rights, but “sale” and even “transfer” are used by some, especially when obligations are also transferred.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

To perfect the sale against a liquidator of the seller, timely registration with respect to a general assignment not in the transfer of a business in good faith and for consideration is required. If, however, in connection with receivables due from the debtor by the time of assignment, the instrument of assignment identifies the debtor, registration would not be required. Additionally, if, in connection with other types of receivables (i.e. existing or future rights (regarding the latter, please see our answer to question 4.10)), the instrument of assignment details the contracts that give rise to those receivables, registration would not be required.

If the assignor assigns a right already assigned to another, the first assignee would prevail, unless the debtor has first been notified of the second assignee. Thus, delivery of notice of assignment to the debtor is important to preserve priority.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under the Assignments Law, all rights ancillary to an assigned right are automatically transferred to the purchaser, provided that such rights are transferable. Nonetheless, in order to perfect its rights against third parties, the purchaser should undertake appropriate actions. For instance, in the event of mortgage loans, the registration in the Land Registry should be amended.

With regard to promissory notes or marketable debt securities that are for the bearer, the seller should transfer them to the purchaser so as to perfect their sale (the Bills Ordinance and the Companies Law, 1999). With regard to promissory notes that are registered with no restriction on their endorsement, the seller should generally endorse the notes to the purchaser to perfect their sale (the Bills Ordinance).

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

As a general matter, Israel’s Assignments Law does not require notification to the debtor in order to perfect an assignment. Nonetheless, under the Assignments Law, notification to the debtor of an assignment can be essential in certain circumstances. Under the Assignments Law, any claim that a debtor has against the assignor, until notified of the assignment, would be valid against the assignee. If a debtor pays the assignor before receiving notification of the assignment, the debtor would be exempt from liability toward the assignee, provided that the debtor acted in good faith.
Additionally, under the Assignments Law, if the assignor assigns a right already assigned to another, the first assignee would be the true assignee, unless the second assignee was first to notify the debtor of the assignment. Thus, it is normally advisable to give notice of assignment to the debtor, to preserve priority.

In principle, the Assignments Law does not require a debtor’s consent in order to recognise an assignment. Nonetheless, the Assignments Law provides that an assignment can be restricted by law, by the essence of the right assigned or by the agreement between the debtor and the assignor.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Please see our answer to question 4.4 above. There is no statutory requirement to deliver a notice to the debtor for an assignment of the debt of such debtor to a third party to be effective under Israeli law, although notice can have a protective function. The Assignments Law does not provide a time limit within which notice of an assignment should be made.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Israel? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Israel recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions in receivables contracts prohibiting sale or assignment are generally enforceable in Israel. In case assignment is conducted despite a prohibition on sale or assignment, the seller may be liable to the obligor for breach of contract even if the assignment itself is not deemed void by the court. The purchaser may be liable for causing breach of contract, if the purchaser caused such a breach knowingly and without justified cause.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

To protect the interests of the assignee, Israel’s Bankruptcy Ordinance requires timely registration with respect to a general assignment not in the transfer of a business in good faith and for consideration. If, however, in connection with receivables due from the debtor by the time of assignment, the instrument of assignment identifies the debtor, registration would not be required. Additionally, if, in connection with other types of receivables, the instrument of assignment details the contracts that give rise to those receivables, registration would not be required. The Bankruptcy Ordinance does not describe what details suffice for identification of debtors or contracts (as the case may be). Case law, however, teaches that at least some details beyond mention of the debtors or contracts must be provided and that the requirement for identification should be construed strictly.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Israel’s Pledges Law, 1967 (“Pledges Law”) regulates generally the charging of property as a security interest. The Pledges Law itself provides that it applies to any transaction intended to charge property as security for an obligation. Thus, the Pledges Law will generally govern a transaction, regardless of how the parties to the transaction designate their arrangement, if the intention of the parties or the effect of the arrangement is to create a charge. Accordingly, absent certain economic characteristics of sale, a sale transaction might be recharacterised by the court as pledge rather than a sale.

There is no binding Israeli case law that addresses the issue of true sale in the context of securitisation. Notably, in Deloitte Touche Brightman Almagor Trusts Ltd. v. Discount Bank Ltd. and others, Civil Application (Tel Aviv), 8120/05, the District Court referred to a securitisation transaction as sale, incidentally, but without analysis of the characteristics of a sale transaction, presumably because the court did not view the characterisation of the transaction as relevant to the matter then before the court.

One of the conclusions of a governmental Examination of the Various Aspects of Asset-Backed Securities Committee Report (published in June 2005) (“ABS Committee Report”) was that the characterisation of a securitisation transaction should be clarified by specific securitisation legislation. However, such legislation is still under the review and study of the Ministry of Justice.

In the absence of legislation and considering the thin case law on the issue, many factors should be considered when considering whether a true sale has taken place. Risk retention or transfer and perfection, among other factors, would be relevant.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The seller may agree to continuous sales of receivables (subject to limitations on the sale of future receivables), but the perfection of the sale can take place only upon or after the creation of the receivables. (Please see the answer to question 4.10 below.)
4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

According to Section 1 of the Assignments Law, “conditional or future” rights are assignable. Nonetheless, in Export Bank Ltd. v. Bank Leumi Le-Israel B.M., Civil Appeal 263/70, PD 24(2) 672, the Supreme Court held in dictum that a right that did not exist at the time of the assignment may not be assigned, because one cannot convey to another a property that does not belong to it. Although the Assignments Law came into force after the decision of Export Bank, the principle established in Export Bank was reaffirmed by the Supreme Court decision in Civil Appeal 717/89, Union Bank v. Eran Tours, PD 49(1) 14, after the Assignments Law became effective. According to this latter Supreme Court ruling, the term “[future right” in §1 of the Assignments Law refers to an existing right that did not yet mature. Accordingly, while the seller may commit to sell receivables upon, or after, such receivables come into existence, receivables which are not in existence at the time of entering into the sale agreement cannot be effectively assigned prior to their creation (i.e., their sale is not perfected). Consequently, if the seller becomes insolvent, the purchaser will not have any proprietary right in the receivables that come into existence following insolvency.

The tone of some recent court rulings is somewhat critical of the Export Bank principle (e.g. Aloni v. Zand Tal Feed Mill Ltd., Civil Appeal 3553/00, PD 57(3) 577), but no Supreme Court decision has yet overruled Export Bank or explicitly discarded the Export Bank principle. In a similar vein, the ABS Committee Report opined that the appropriate interpretation of existing law allows for assignment of future rights in a securitisation context (and further noted that such assignment would generally need to be registered with the Companies Registrar – please see our answers to questions 3.2 to 3.6 above – and should clearly be reported as such in the financial reports of the seller), yet specifically recommended that securitisation legislation provide for the assignment of future rights.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Generally, under the Assignments Law, all rights ancillary to an assigned right are automatically transferred to the purchaser, provided that such rights are transferable. Nonetheless, in order to perfect its rights against third parties, a purchaser should undertake appropriate actions, such as amend existing pledges registry, etc. Notably, according to a leading Israeli academic even where the relevant registry is not amended – i.e. the assignor remains the registered creditor – the assignee’s security interest should be valid.

5 Security Issues

5.1 Back-up Security. Is it customary in Israel to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

The Companies Regulations (Reporting, Registration Details and Forms), 1999 allow registration of a pledge along with a notice stating that the registration does not by itself indicate that the parties’ intended that the asset subject to the transaction will be utilised as a pledge. This is a matter that is commonly negotiated between the parties, in which the degree of certainty of the assignment features.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Israel, and for such security interest to be perfected?

Please see the answer to question 5.1 above. The registration will include the notice described in the answer to question 5.1 above.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Israel to grant and perfect a security interest in purchased receivables governed by the laws of Israel and the related security?

Under the Companies Ordinance, 1983, a company-pledgor must register the details of the security interest, and the document constituting such security interest, with the Israeli companies’ registrar within twenty-one days of the date of the security interest, for such pledge to be effective against a liquidator or any other creditor of the company. In case of a programme for the issuance of one or more series of secured notes, secured pari passu among the holders of such notes, the issuer is required to provide to the registrar only certain details upon each actual issuance of a series of secured notes for the security to be effective against third parties. In addition, a pledgor is required to keep a security interests/pledges book in its registered office and to register any such security in that book.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Israel, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Israel or must additional steps be taken in Israel?

Israeli case law, while relatively thin in this area, indicates that proprietary rights with regard to an asset are governed by the lex situs of such asset. Where such asset is a right, case law, which in this area too is relatively thin, indicates that the law of the most effective place of enforcement of such right should be the lex situs of such right.

If the purchaser is Israeli the security interest should be perfected under Israeli law. If it is not, as the receivables are governed by Israeli law, Israeli law could be the lex situs of the receivables and the security interest should be perfected also according to such law.
5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Perfection of security interests in promissory notes or marketable debt securities can be done either by: (i) delivery of such notes or securities to the creditor, provided that such notes or securities are for the bearer (i.e., that their holder is entitled to collect the debts represented by them by presentation only); (ii) registration of a pledge with the Companies Registrar, where the pledgor is an Israeli corporation; or (iii) registration of a pledge with the Pledges Registrar, where the pledgor is not an Israeli corporation.

If the pledgor is an Israeli corporation, perfection of security interest in consumer loans would be by registration of the pledge with the Companies Registrar. If the pledgor is not an Israeli corporation, the registration would be with the Pledges Registrar. Perfection of security interests in mortgage loans depends on the type of security interest provided to secure the loan. Israel’s Lands Law, 1969 (“Lands Law”) provides that a mortgage over registered ownership (or a registered lease) will be by way of mortgage only. Thus, a mortgage can be provided as security with regard to registered rights only and cannot be granted over rights in unregistered land or in unregistered condominium. Under the Lands Law, perfection of a mortgage is by way of registration with the Lands Registry. Notably, if the pledgor is an Israeli corporation, additional registration in the Companies Registrar is required in order to perfect the mortgage under the Companies Ordinance. Principally, registration of a mortgage over registered ownership (or registered lease) in unsettled land requires the approval of the Official Settlement Clerk.

While mortgages cannot be granted over unregistered rights, certain security interests can be granted over rights in unregistered land and rights in unregistered condominiums. These security interests are: (i) cautionary notes – registration of cautionary notes with the Lands Registry can be accomplished under the Lands Law, which provides that upon registration of a cautionary note: (a) no contradicting transaction may be registered without the agreement of the beneficiary of such note or a court order; and (b) no harm will be caused to the beneficiary of such note as a result of a lien, bankruptcy or winding up of the registered owner of the land or of a right in the land. Notably, a cautionary note can be registered in connection with unregistered rights and rights in unregistered condominiums where the relevant assets are situated on registered land, but they cannot be registered in connection with unregistered lands; and (ii) registration of a pledge – registration of a pledge over contractual rights can be accomplished in the Pledges Registrar, if the debtor is not a corporation, and in the Companies Registrar, pursuant to the Companies Ordinance, if the debtor is a corporation.

5.6 Trusts. Does Israel recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, according to Israel’s Trust Law, 1979 (“Trust Law”), a trust is an affiliation to an asset pursuant to which the trustee must hold or act upon such asset for the benefit of a beneficiary or other purpose. A trust may be created through law, contract or endowment statement.

5.7 Bank Accounts. Does Israel recognise escrow accounts?

Israel recognises escrow accounts, subject to certain disclosure requirements under the Anti-Money Laundering Law, 2000. Security may be taken over the rights of the owner of a bank account located in Israel. In case the owner of the bank account is an Israeli corporate entity, the security interest would be registered with the Companies Registrar. In case of an individual or other entity (other than an Israeli corporate entity), the security interest would be registered with the Pledges Registrar. In case a bank account is located in Israel or in case the pledgor is an Israeli entity, perfection should be conducted in Israel (foreign law grant of security may be used for such registration, but translation to Hebrew may be required).

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Under Israel’s Pledge Law, realisation of chattels can be done pursuant to a court order or by order of the head of the execution office. If by the court, the court may appoint a receiver to manage the collateral and such receiver shall gain control over the secured bank account and access thereto until the secured party is repaid in full and all other costs and expenses related to the enforcement of the security, including the receiver’s fees are paid in full, and any balance in the secured bank account after such payments shall belong to the debtor.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, although this may serve as an indication that the security is a floating charge.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Israel’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (“stay of action”? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the transaction is considered a true sale and the seller becomes insolvent, insolvency proceedings should not affect the rights of the purchaser as the owner of the receivables. Nonetheless, upon appointment of a liquidator to a company, all assets of such company and any asset that seems to belong to such company become subject to the liquidator’s management and supervision.
Accordingly, if the receivables can seem to be part of the seller’s assets, the liquidator may stay collections claiming that the company owns the receivables, until the court determines otherwise.

As a general matter, Israeli law does not recognise the concept of “automatic stay”. Nonetheless, the Companies Ordinance provides that following a liquidation order or appointment of a temporary liquidator there shall be no legal proceedings against the company, unless the court orders otherwise. After submission of an application for liquidation, and before a liquidation order, the court may, at its sole discretion, and if requested, order a stay of proceedings. In addition, Israel’s Companies Law, 1999 (“Companies Law”) provides that in rehabilitation proceedings for an insolvent but not liquidated company, the court may, at its sole discretion, order a stay of up to nine months. During that term a secured creditor will need to apply to the court in order to realise a pledge and the court will allow realisation of a pledge in case no other security had been designated in place of the pledge and if the realisation will not have an adverse effect on the rehabilitation of the company.

In case the purchaser is deemed to only be a secured party rather than the owner of the receivables, the purchaser would be required to submit a debt claim with the liquidator, which would realise the pledged asset (i.e. the receivables) in the course of the insolvency proceedings.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Please see the answer to question 6.1 above. Generally, if the insolvency official argues in court that the sale is not a true sale so that the proceeds of the receivables belong to the seller, the court may, until the matter is concluded, issue a stay order.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Israel for (a) transactions between unrelated parties and (b) transactions between related parties?

The Companies Ordinance provides that any corporate act in relation to assets that would be a voidable preference in a personal bankruptcy is also a voidable preference by the acting corporation and void against that corporation’s liquidator. Under the Bankruptcy Ordinance, if an individual is unable to pay his debts as they fall due with his own money, and, in favour of any creditor, transfers or charges property, makes a payment, inures an obligation or takes or suffers a judicial proceeding, that action is deemed improper and void against the person’s trustee in bankruptcy. This is only true, however, if that person is adjudged bankrupt as a result of a petition filed within three months of the identified action. Additionally, case law indicates that, for the voider to apply, it must be shown or inferred from the circumstances that the identified action was done with a dominant intent to prefer a creditor.

There is no distinction between related and unrelated parties for the purpose of the length of the “suspect period”.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvent official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Such consolidation would be possible should a court pierce the corporate veil of the purchaser. This would be possible if the purchaser and the seller are affiliates (i.e. the seller is a shareholder of the purchaser or vice versa). The Companies Law lists the circumstances in which a court may pierce the veil over a company: (1) the separate legal entity was used in order to defraud or discriminate against any person; (2) the separate legal entity was used in order to foil the purpose of the company while taking unreasonable risk as to its ability to pay its debts, provided that the shareholder was aware of such use taking into account such shareholder’s holdings and performance of obligations under the Companies Law and the ability of the company to pay its debts; or (3) under the circumstances it is justified to do so, taking into account that it is reasonable to assume that the management of the company was not conducted for the benefit of the company or took unreasonable risk as to the ability of the company to pay off its debts.

Additionally, as indicated above, if the seller and purchaser are not related, the insolvency official can argue in court that the sale is not a true sale so that the proceeds of the receivables belong to the seller.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Israel, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

The Companies Ordinance provides that, as of the filing of a petition for liquidation, any transaction conducted with the company’s assets would be void, unless permitted by the court. Accordingly, sales of receivables that take place after the commencement of liquidation proceedings should be considered void, unless approved by the court. Nevertheless, performance of an executor contract should not conflict with the Companies Ordinance, but a liquidator may, with court permission, waive an insolvent company’s onerous assets.

Regarding a sale of future receivables, please see the answer to question 4.10 above.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Israel establishing a legal framework for securitisation transactions? If so, what are the basics?

No. The ABS Committee Report recommends special legislation for securitisation transactions. The Ministry of Justice circulated a draft securitisation law in 2008, but to date the draft has not matured to a statute.
7.2 Securitisation Entities. Does Israel have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No. The ABS Committee Report recommends settling the establishment of special purpose entities for securitisation purposes in specific securitisation legislation. In the meantime, the structure of private companies is what is commonly used.

7.3 Non-Recourse Clause. Will a court in Israel give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

There is no specific rule against non-recourse clause. As a general matter, the court is authorised to void a clause in an agreement based on various legal grounds, such as: public interest; illegality; lack of authority; lack of capacity; or deprivation in a unified contract.

7.4 Non-Petition Clause. Will a court in Israel give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

As a general matter, the court is authorised to void a clause in an agreement based on various legal grounds, such as: public interest; illegality; lack of authority; lack of capacity; or deprivation in a unified contract. While there is no specific rule against such a non-petition clause, courts are disinclined to give effect to a provision that prohibits a party from taking legal action for a future breach of contract, as opposed to a breach that has already been made.

7.5 Priority of Payments “Waterfall”. Will a court in Israel give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Prior to insolvency, a court in Israel should give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract, but if insolvency proceedings in Israel have begun, insolvency proceedings, including order of payments to creditors, will override the contractual waterfall.

7.6 Independent Director. Will a court in Israel give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

A provision in the Articles of Association of a company or in a contract entered into by the company that restricts or limits the ability of the directors to bring insolvency proceedings could be invalid for reason of public policy or incompatibility with certain statutory duties of directors.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Israel, will its purchase and ownership or its collection and enforcement of receivables result in its being subject to public policy or incompatibility with certain laws of Israeli law? Does the answer to the preceding question change if the purchaser does business with other sellers in Israel?

Section 346 of the Companies Law provides that a foreign company shall not maintain a place of business in Israel unless registered with the Companies Registrar as a foreign company. The purchaser can be considered to maintain a place of business in Israel due to intense collection and enforcement of receivables conducted in Israel. If the purchaser does business in Israel (i.e., not remotely) with other sellers, it may be deemed to maintain a place of business in Israel.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Collection and enforcement of receivables does not necessitate a regulatory licence under Israeli law.

8.3 Data Protection. Does Israel have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Israel’s Privacy Protection Law, 1981 (“Privacy Law”) prohibits certain invasions of privacy. Except in the case of illegal eavesdropping, the Law’s list of prohibited privacy invasions do not protect organised legal entities, such as corporations. In addition, Chapter B of the Privacy Law requires registration of certain information databases, when the data relates to persons that are not organised legal entities, and sets out strict procedures as to the management of the information database.

The purchaser gathers personal information on Israeli individuals or maintains an information database concerning data relating to individuals (“Information Database”), the purchaser may be required to register such Information Database with the Information Databases Registrar. The Privacy Law provides that an Information Database should be registered if it: (i) contains data with regard to 10,000 individuals or more; (ii) contains sensitive data; (iii) contains information not provided by the individuals included in such database or not with their consent; (iv) is owned by a public entity; or (v) is used for provision of direct mail services.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Israel? Briefly, what is required?

The Consumer Protection Law applies various obligations to providers and manufacturers of goods or services. Accordingly, and because the seller only sells to the purchaser the right to receive money from the debtor, the purchaser should not be subject to the obligations applicable to the seller by the Consumer Protection Law.
8.5 Currency Restrictions. Does Israel have laws restricting the exchange of Israel's currency for other currencies or the making of payments in Israel's currency to persons outside the country?

Under the amended Currency Control Permit, 1998, issued to relax restrictions under the Currency Control Law, 1978, relevant substantive restrictions no longer apply to foreign currency transactions. Please note, however, that certain reporting obligations do apply to individuals, companies, currency services providers, banks and other financial institutions engaging in currency transactions.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Israel? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

As the purchaser will ultimately pay the Israeli seller less than the aggregate face amount of the purchased receivables, there is a risk that the discount from the face amount, under some circumstances, will be regarded as interest, to the payment of which withholding tax rules would apply. Accordingly, Israeli sellers commonly seek to obtain a transaction-specific pre-ruling from the Israeli Tax Authority regarding withholding in a securitisation context. Notably, in international transactions, tax treaty issues should be considered.

9.2 Seller Tax Accounting. Does Israel require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

In general, the tax authority applies the Israeli general acceptable accounting principles. The Israel Accounting Standards Board has decided to adopt the principles of IAS 39 as of 2008.

9.3 Stamp Duty, etc. Does Israel impose stamp duty or other documentary taxes on sales of receivables?

For documents signed as of 1 January 2006, no stamp duty is imposed. In general, Israel’s Stamp Tax on Documents Law, 1961 imposes stamp duty on documents signed before 1 January 2006 and exempts from stamp duty documents executed in relation to a securitisation transaction.

9.4 Value Added Taxes. Does Israel impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

In general, Israel’s Value Added Tax Law, 1975 (“VAT Law”) imposes value added tax on sales of goods and services (including servicing fees) conducted in the course of the seller’s business. The VAT Law is applicable to sales executed in Israel. The VAT Law provides that with regard to intangible assets, the sale would be considered as executed in Israel, if the seller is an Israeli resident. The VAT Law also provides that a service will be considered as provided in Israel if: (i) the provider maintains a place of business in Israel; (ii) it is provided to an Israeli resident; or (iii) the service is with regard to assets in Israel. The VAT authority issues pre-rulings with regard to the applicability of the VAT law to securitisation transactions on a case-by-case basis.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

In principle, the payment of VAT is imposed on the seller of goods or provider of services. Normally, the taxing authority will not be able to make claims against the purchaser, in case the seller does not pay. However, the VAT Law permits the tax authority to make claims against an entity that is not the tax obligor in certain circumstances. One such example is assets transferred to another entity by the obligor for no consideration or for partial consideration and the obligor has a “special relationship”, a term defined in the Israeli Customs Ordinance, with that entity and does not maintain any assets in Israel.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Israel, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Israel?

As a general matter, so long the purchaser conducts its activities in their entirely outside of Israel it should not be liable to tax in Israel, by reason of purchase of receivables, appointment of seller as service and enforcement of receivables against debtors. Please see the answer to question 9.1 above.

Note

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Caspi & Co. is one of Israel’s oldest and best known law firms. Since its founding in 1927, the firm has maintained a vibrant domestic and international practice. The firm serves as outside counsel to a variety of major corporations, financial institutions, investment groups, project developers and governmental entities and commonly plays a role in many of Israel’s preeminent transactions and notable litigations. Regular involvement with major actors and innovative issues positions the firm as a top-rate adviser and advocate that can provide a variety of critical and cutting-edge legal services.

Caspi & Co. prides itself on its market-leading and deep experience in structured finance and derivatives. The firm counselled the arrangers of Israel’s first two significant securitisations, has advised on a number of international securitisation and currently counsels extensively on various securitisation and over-the-counter derivative transactions. Firm partner Norman Menachem Feder leads the structured finance and derivatives practices and is commonly rated highly by professional reviewers.

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) The general principle applicable under Italian law is that no formality exists in respect of the execution or evidence of contracts. Nonetheless, according to specific provisions of the law, written form is required for the validity of certain contracts or for providing evidence in respect thereof.

(b) Invoices may be construed as relevant receivables documents and they may be deemed to constitute evidence of a contractual relationship. Whenever the invoices represent a claim which is certain, liquid and payable (according to Article 633 of the Italian Civil Procedure Code), the relevant creditor may obtain from the court an injunction to pay against the debtor.

(c) The behaviour of the parties is not per se sufficient to be the base for the existence of a contract. Pursuant to Article 1362 of the Italian Civil Code, the behaviour of the parties may be used as an interpretation criterion, in order to establish the mutual intention of the parties.

1.2 Consumer Protections. Do Italy’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) Law No. 108 of 7 March 1996 (“Usury Law”) contains provisions limiting rates of interest applicable to receivables. In particular, the rate of interest exceeding the percentage rates published on a quarterly basis by the Ministry of Economy is considered to be void.

(b) Pursuant to Article 1224 of the Italian Civil Code, a debtor who fails to pay a monetary obligation will be bound to pay legal interest starting from the day of default even if the relevant agreement did not provide for the payment of any such interest. If the agreement provides for an interest rate higher than the legal interest rate, the default interest will be due at such rate.

(c) It is conceivable that, in specific circumstances and subject to specific provisions of the law, debtors may obtain a suspension of their payment obligations for a given period of time.

(d) The Italian legal system provides several instruments to protect consumers when they enter into an agreement with professional operators. Among others, please refer to Legislative Decree No. 206 of 6 September 2006 (the “Consumers’ Code”). In case of transfer of consumer loans, the consumer is entitled to raise against the purchaser the same exceptions it could have raised against the seller, including, by way of derogation of Article 1248 of the Italian Civil Code, any right of set-off.

Articles 121 to 126 of Legislative Decree of No. 385 of 1 September 1993 (the “Banking Law”), as recently modified in order to comply with Directive 2008/48/CE, provide for the protection of consumers in the context of consumer credit transactions. In this regard, Legislative Decree No. 141 of 13 August 2010 introduced new forms of protection on the basis of certain transparency and disclosure duties applicable to lenders.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

The assignment of receivables owed by public entities is regulated by specific provisions of law (please refer, inter alia, to Royal Decree No. 2440 of 24 November 1923). Assignment of receivables is effective vis-à-vis public entities only if (a) the relevant assignment agreement is entered into in the form of a public deed or a notarised private deed, (b) the receivables assigned in the context of the agreement are all vis-à-vis a single debtor, and (c) the assignment is accepted by the debtor with date certain at law or notice thereof is given to the public entity through notification made by a court bailiff.

In case of receivables arising from a supply contract or bid contract (which have not been completely performed), the sale of the receivables is not valid without the public entity’s consent. Moreover, according to the provisions of Article 117 of Legislative Decree No. 163 of 12 April 2006 (“Public Contracts Law”), a contractor may assign receivables arising from a public contract to banks or other financial intermediaries. Such agreement must be executed in the form of public deed or notarised private deed, notified to the relevant debtor and will be deemed to be perfected upon the expiration of a 45-day term starting from the date of notification during which period the public debtor has the right to object to the assignment.
2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Italy that will determine the governing law of the contract?

Pursuant to Article 4, paragraph 1 of Regulation No. 593 of 2008 of the European Parliament and of the Council on the Law Applicable to Contractual Obligations ("Rome I Regulation"), if the parties have not made an explicit choice of the applicable law, different criteria will apply depending on the nature of relevant agreement. If the agreement does not fall within one of the categories set forth in paragraph 1 of the Rome I Regulation, it will be governed by the law of the country where the party required to effect the characteristic performance of the contract has his/her habitual residence. However, whenever it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indentified by the above-mentioned criterion, the law of that other country shall apply.

According to Article 6 of the Rome I Regulation, if the contract is entered into by a consumer, it shall be governed by the law of the country where the consumer has his habitual residence, provided that the professional: (a) pursues his commercial or professional activities in the country where the consumer has his/her habitual residence; or (b) by any means, directs such activities to that country or to several countries (including that country), and the contract falls within the scope of such activities.

2.2 Base Case. If the seller and the obligor are both resident in Italy, and the transactions giving rise to the receivables and the payment of the receivables take place in Italy, and the seller and the obligor choose the law of Italy to govern the receivables contract, is there any reason why a court in Italy would not give effect to their choice of law?

An Italian court would give effect to the choice of law made by the contracting parties. In the circumstances described above there would be no reason why Italian courts would not give effect to the choice of Italian law to govern the receivables.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Italy but the obligor is not, or if the obligor is resident in Italy but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Italy give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The parties to a contract may freely choose the law applicable to the whole or a part of the contract, and select the court that will have jurisdiction over disputes, provided that any such choice does not conflict with any provisions of Italian law of mandatory application. Generally the principles setting limits to the recognition of foreign laws (such as public policy or mandatory principles of law) do not apply to commercial relationships, nonetheless there might be situations such as consumer contracts where Italian mandatory rules of law would apply notwithstanding any different choice of law by the parties.


Yes, it is.

3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Italy’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Italy’s laws or foreign laws)?

According to the provision set forth under Article 14 of the Rome I Regulation, it is permitted that the sale of receivables be governed by a law other than the law governing the receivables themselves. In this case, the law governing the assigned claim shall determine whether the receivables are capable of being assigned, the relationship between the assignee and the debtor, the conditions under which the assignment can be opposed against the debtor and whether the debtor’s obligations have been discharged. Moreover, pursuant to Article 9 of the Rome I Regulation, overriding mandatory provisions must be applied whatever the law applicable to the contract might be.

3.2 Example 1: If (a) the seller and the obligor are located in Italy, (b) the receivable is governed by the law of Italy, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Italy to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Italy, will a court in Italy recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Pursuant to Article 11, paragraph 2, of the Rome I Regulation, a contract between persons who are in different countries at the time of its conclusion is formally valid if it satisfies the formal requirements provided by the law which governs the substance of the same. In the case envisaged, Italian courts would recognise the effectiveness of the sale.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Italy, will a court in Italy recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

As explained above with respect to question 3.1, according to Article 14, paragraph 2, of the Rome I Regulation, the law governing the assigned claims shall determine whether the receivables are capable of being assigned, the relationship between the assignee and the debtor, the conditions under which the assignment can be opposed against the debtor and whether the debtor’s obligations have been discharged. Therefore the circumstance that the obligor and the purchaser are located outside Italy would not affect the effectiveness of the sale vis-à-vis the seller and his creditors or receivers.
3.4 Example 3: If (a) the seller is located in Italy but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Italy recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Italy’s own sale requirements?

According to the general principle of the freedom to choose foreign law, Italian courts may give effect to the choice of law made by the parties, and the seller would not need to comply with Italian requirements. However, the application of a foreign law may not prevent the Italian judge from applying overriding mandatory provisions of Italian law, whenever relevant.

3.5 Example 4: If (a) the obligor is located in Italy but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Italy recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Italy’s own sale requirements?

According to Article 11, paragraph 1 of the Rome I Regulation, a contract between persons who are in the same country at the time of its conclusion is formally valid if it satisfies the formal requirements provided by the law which governs the substance of the same or of the law of the country where the contract is concluded. According to Article 14, paragraph 2 of Rome I Regulation, the law governing the assigned claim shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and whether the debtor’s obligations have been discharged.

3.6 Example 5: If (a) the seller is located in Italy (irrespective of the obligor’s location), (b) the receivable is governed by the law of Italy, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Italy recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Italy and any third party creditor or insolvency administrator of any such obligor)?

Please make reference to question 3.2 above. In this case, however, the application of foreign law may not prevent the Italian judge from applying overriding mandatory provisions of Italian law, whenever relevant. Furthermore, according to Article 14, paragraph 2 of the Rome I Regulation, to recognise the effectiveness of the sale, in addition to the requirements of the law governing the receivables purchase agreement, also the requirements provided by Italian law must be satisfied.

4 Asset Sales

4.1 Sale Methods Generally. In Italy what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Pursuant to Article 1260 of the Italian Civil Code, a creditor may assign its receivables without the debtor’s consent, subject to certain limitations deriving from the specific characteristics of the receivables.

The receivables are transferred by means of an agreement between the seller and the purchaser.

The terms generally used to identify this method of selling receivables are “transfer” or “assignment”.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

According to Article 1264 of the Italian Civil Code, the assignment is valid and binding as against the assigned debtor if the debtor has accepted the assignment or has received notice thereof.

In respect of subsequent good faith purchasers, Article 1265 of the Italian Civil Code provides that if the same receivable has been the object of more than one assignment, the first assignment in respect of which the debtor has been notified or which the debtor has accepted at a certain date under law (data certa) shall prevail.

Different rules apply if the assignment of receivables takes place in the context of a securitisation transaction. Under law No. 130 of 1999 (“Securitisation Law”) the sale of receivables is perfected upon registration of the transfer agreement with the Companies’ Register and publication of a notice of the assignment in the Official Gazette.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In order to assign Promissory Notes the seller is required to endorse them in favour of the purchaser.

The transfer of mortgage loans is made by way of a transfer agreement. However, in order to perfect the transfer of the mortgage security vis-à-vis third parties, Article 2843 of the Italian Civil Code provides that the assignment must be annotated at the margin of the mortgage registration in the competent land register offices.

The modalities of the transfer of debt securities may vary depending on the particular characteristics of the debt securities to be assigned.

Under Italian law, debt securities may take the form of registered securities, bearer securities or order securities. In addition, further to Legislative Decree No. 58 of 24 February 1998 (“Financial Act”), financial instruments, including debt securities, which are negotiated in the market, are issued in dematerialised form. According to Articles 83-bis and following of the Financial Act such instruments must be held and managed by centralised management companies (società di gestione accentrata). Pursuant to Article 86 of the Financial Act, the owner of dematerialised
The sale of consumer loans does not require specific formalities.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

With regard to the first question, please make reference to question 4.2 above. In general terms, the consent of the debtor is not required.

(a) If the contract does not expressly regulate the assignment, general principles apply according to which a creditor may freely assign receivables, provided that the receivables do not have a strictly personal character or that the transfer is not forbidden by law.

(b) If the contract expressly prohibits assignment, the receivables cannot be transferred without the debtor’s consent.

In relation to the last question, there are benefits in giving notice of the assignment to the obligors. This is because, as a general rule, pursuant to Article 1248, paragraph 2, of the Italian Civil Code, the assigned obligors are entitled to exercise the right of set-off only in relation to obligations of the seller which have arisen before the date on which the debtors have been served notice of the assignment, and the transfer of the receivables has therefore been made enforceable (opponibile) against them.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

In relation to the first question, please make reference to question 4.2 above. In general terms, according to Article 1264 of the Italian Civil Code, the assignment is valid and binding against the assigned debtor and other third parties if the debtor has accepted the assignment or has received notice thereof.

There is no specific time limit for the notice to be delivered to obligors but, according to Article 45 of Royal Decree No. 267 of 16 March 1942 ("Italian Bankruptcy Law"), the assignment of receivables shall be binding on the bankruptcy receiver if it was perfected prior to the time when the seller became insolvent. However, the assignment may be revoked, if the bankruptcy receiver is able to prove that the purchaser was aware or should have been aware of the insolvency of the seller, and the assignment contract was entered into during the suspect period. Please note that if the receivables are transferred in the context of a securitisation transaction the suspect period term provided under Article 67 of Italian Bankruptcy Law is reduced from six to three months.

Notice mechanics apply to all types of receivables, future ones included. In case of existing receivables, in respect of which an agreement has already been signed, reference should be made to the initial notice delivered at the time of the conclusion of that agreement. In case of future receivables, in respect of which no agreement has been concluded yet, the notice should be delivered only when these receivables arise.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Italy? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Italy recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Italian law provides some express prohibitions in respect of the sale of receivables. For instance, the sale of receivables of a strictly personal character is forbidden. In case of violation of the prohibitions provided by law, an Italian court may declare the invalidity of the assignment.

The parties to an agreement may agree that the receivables arising thereunder cannot be assigned to third parties. In such a case, if the seller sells the receivables without the debtor’s consent, the assignment of receivables is valid and effective against the debtor, unless evidence is given that the purchaser was aware of the prohibition. In such a case the seller is liable for breach of contract vis-à-vis the debtor and shall indemnify the debtor for any damages incurred by it.

Certain limitations are also provided in case of receivables against public entities, arising from public contracts which have not been completely performed.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

According to general principles of Italian law, the object (oggetto) of a contract needs to be identified or identifiable (please refer to
Article 1346 of the Italian Civil Code). In this regard, a transfer contract must indentify the receivables or, at least, provide sufficient criteria allowing receivables to be identified. There is no specific information that has to be given mandatorily. However, pursuant to Article 1262 of the Italian Civil Code, the assignor is obliged to deliver the documents evidencing the receivables in his possession to the assignee.

The securitisation law provides for a specific set of rules in respect of the assignment of receivables. In particular, if the receivables to be transferred in the context of a securitisation transaction are more than one, they need to be transferred “in blocco”.

The definition of receivables identifiable “in blocco” is provided in the Bank of Italy regulations (istruzioni di vigilanza), as amended and supplemented from time to time, issued by the Bank of Italy in relation to Article 58 of the Banking Law (which is expressly referred to by Article 4 of Law 130). In particular, legal relationships identifiable “in blocco” are defined as “credits, debts and contracts which have a common element of identification; such element may consist of the technical form, the economic sector of destination, the type of counterparty, the geographical area or any other element which allows identification of the relationship transferred “in blocco”.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

According to the interpretation criteria set forth under Article 1362 and following of the Italian Civil Code, courts shall apply the principle according to which the intent of the parties shall always prevail over any other aspects.

According to Article 1267 of the Italian Civil Code, the seller may guarantee to the purchaser the obligations of the debtor. This would impair the ‘without recourse’ nature of the sale.

The seller may act as servicer or as interest rate swap provider, or may be granted with an option to repurchase part of the receivables, without impairing the true sale and the ‘without recourse’ nature of the sale.

The features above may have an effect on the accounting treatment of the sale.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e. sales of receivables as and when they arise)?

Yes. The parties may freely determine the contents of the contract within the limits imposed by law and provided that the contract is directed to achieve interests which are worth protecting according to the Italian legal system.

In the context of securitisation transactions, revolving assignments are expressly admitted. Pursuant to Article 2, paragraph 3, e) of the Italian Securitisation Law the special purpose vehicle may reinvest the cash flows, that are not immediately used for paying principal on the issued bonds in further receivables.

Moreover, continuous sales of receivables may take place in the context of factoring transactions according to Article 1 of Law No. 52 of 21 February 1991 (“Factoring Law”). For the application of such law the following requirements need to be fulfilled: (i) the assignor must be an entrepreneur; (ii) the assigned receivables must arise from contracts entered into by the assignor in the context of its professional activity; and (iii) the assignee must be a bank or a financial institution having as its sole corporate purpose that of carrying out factoring transactions.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

The sale of future receivables is allowed in Italy, subject to the condition that the source of the assigned receivables existed as of the date of the sale and provided that any such sale would become effective only upon the future receivables coming to existence.

In this context please also refer to Article 1 of the Italian Securitisation Law, which expressly authorises the assignment of present and future receivables in the context of the securitisation transactions.

Furthermore and according to Article 3 of the Factoring Law, assignment of future receivables is authorised, provided that the contracts from which such future receivables will arise are executed within 24 months from the date of relevant assignment agreement.

If the receivables have not yet come into existence as of the date of the declaration of bankruptcy of the seller, then the commitment to sell any receivables arising after the insolvency of the seller would be ineffective vis-à-vis the bankruptcy receiver and third parties generally.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Pursuant to Article 1263 of Italian Civil Code, by effect of the assignment, the receivables are transferred to the assignee together with any privileges, real or personal guarantees, and other related security.

Certain formalities are required by Italian law for the effectiveness of the transfer of certain security interest. In this respect please consider, by way of example, the formalities required by the Italian Civil Code in respect of mortgages (see question 4.3 above).

As a consequence of the application of Article 4 of the Securitisation Law to the assignment of receivables, no registration of the mortgages, nor notation or transfer of the security interests, guarantees, privileges and priority rights supporting the receivables and all other rights, benefits and accessories pertaining thereto, is required in order for them to be enforceable by the purchaser in its own name.
5. Security Issues

5.1 Back-up Security. Is it customary in Italy to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

This is not applicable.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Italy, and for such security interest to be perfected?

This is not applicable.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Italy to grant and perfect a security interest in purchased receivables governed by the laws of Italy and the related security?

This is not applicable.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Italy, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Italy or must additional steps be taken in Italy?

According to general principles of Italian private international law, security interests in receivables shall be deemed as a perfected security in Italy, even if is regulated under the laws of a third country, upon the condition that the relevant formalities provided under Italian law are fulfilled.

The security interest in the receivables perfected under a foreign law would be recognised as a valid and perfected security if the granting and the formalities of such security is compliant with such foreign law and is not in breach of mandatory provisions of Italian law.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Please make reference to question 4.3 (Perfection of Promissory notes, etc.) above.

5.6 Trusts. Does Italy recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Trusts are recognised and enforced in Italy by virtue of the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition, which was ratified pursuant to Italian Law No. 364 of 16 October 1989, which came into force on 1 January 1992. As there is no domestic legislation relating to trusts, trusts can only be established in Italy in accordance with the Hague Convention and subject to a foreign governing law.

5.7 Bank Accounts. Does Italy recognise escrow accounts? Can security be taken over a bank account located in Italy? If so, what is the typical method? Would courts in Italy recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Italy?

The most common method to constitute an escrow over a bank account in Italy is the creation of a pledge over the sums credited into such accounts. According to Article 51 of Law No. 218 of 31 May 1998, an Italian court would recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Italy to the extent that all the formalities provided under Italian law for the creation of a security over account are fulfilled (please refer also to Article 55 of the same law).

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Pursuant to Italian Law, upon the occurrence of an enforcement event, the secured creditor is entitled to withhold any amount standing to the credit of each of the pledged accounts as of the date of the enforcement, applying it to the complete discharge of the secured obligations, provided that any excess of the pledged credit balance shall be discharged and made available to the pledgor.

Notwithstanding the above, upon the opening of a bankruptcy proceeding in respect of the pledgor, the lenders, even if privileged creditors, shall submit their recovery credit request to the bankruptcy procedure and could be satisfied only at the conclusion of the latter.

Please note that under a special legislation (i.e. Legislative Decree of 21 May 2004, No. 170) applicable in certain circumstances to pledge over bank accounts, even if a bankruptcy proceeding has been opened in respect of the pledgor, the lenders may withhold any amount standing to the credit of each of the pledged accounts and apply such amounts in discharging the secured obligations, informing in writing the pledgor and the bodies of the insolvency proceedings about the manner of enforcement and the relevant proceeds.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Until the occurrence of an enforcement event, the pledgor may be contractually entitled to use amounts deposited on the pledged accounts in accordance with the terms and conditions set forth under the relevant facility documents.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Italy’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Italian Bankruptcy Law does not provide for an automatic stay clause on the purchaser.

The bankruptcy receiver is empowered, among others, to manage and liquidate the assets and, for such purpose, he is entitled to institute any action to set aside and revoke the transactions carried out during the so-called “suspect period”. Until any such sale is revoked, the bankruptcy receiver has no power to stay collections.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Under Italian law no specific measures are provided to prohibit the purchaser’s exercise of rights, in the context of an insolvency procedure.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Italy for (a) transactions between unrelated parties and (b) transactions between related parties?

According to Articles 64 and 65 of the Italian Bankruptcy Law, the following transaction are void vis-à-vis creditors (and the declaration that the transaction is void is not subject to any terms of prescription): (a) transactions without consideration for the benefit of the bankrupt which were carried out in the two years prior to the declaration of bankruptcy (including security rights given in respect of third party debts not contemporaneously created); and (b) payments of debts which expire on the date of the declaration of bankruptcy or thereafter, if said payments have been made in the two years prior to the declaration of bankruptcy.

Pursuant to Article 67 of Italian Bankruptcy Law, the clawback action may be successfully filed and pursued by the bankruptcy receiver in connection with the following transactions, unless the counterparty proves that it had no knowledge of the state of insolvency of the individual entrepreneur or corporation that was declared insolvent:

(a) transactions concluded in the one year prior to the declaration of insolvency in which the obligations performed or assumed by the debtor exceed by more than one quarter of what the debtor received;

(b) payment of overdue monetary debt obligations where payment was not made with money or other normal means of payment, if made in the one year prior to the declaration of insolvency; and

(c) pledges, securities and mortgages judicially imposed or voluntary created in the six months prior to the declaration of insolvency in respect of overdue obligations.

Moreover, payment of liquid and enforceable debts, transactions for consideration and transactions where security rights are given in respect of contemporaneously created debts (including debts towards third parties) which are effected in the six months prior to the declaration of insolvency shall be subject to the clawback action, if the bankruptcy receiver can prove that the counterparty was aware or should have been aware of the state of insolvency.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Under Italian law the bankruptcy receiver may not consolidate the assets and liabilities of the purchaser with those of the seller and its affiliates.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Italy, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

(a) If the sale of receivables has not yet become effective before the declaration of insolvency, the transfer shall not take place after such a declaration.

(b) Please make reference to question 4.9 above.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Italy establishing a legal framework for securitisation transactions? If so, what are the basics?

The Securitisation Law recognises and regulates securitisation transactions in Italy.

The basic aspects of such law are as follows:

(i) securitisation law applies to securitisations carried out by way of non-gratuitous assignment of monetary certain receivables to special purpose companies (SPV), which issue notes to be repaid using the cash flow arising from collections in respect of the receivables;

(ii) if the receivables to be transferred in the context of a securitisation transaction are more than one, they need to be transferred in blocco;

(iii) all the receivables purchased by the issuer and collections in respect thereof which are paid after the publication of the notice of assignment in the Official Gazette and the issue of the notes are segregated from all other assets of the issuer and may not be attached or foreclosed by any party which is not a holder of the notes;

(iv) in the event of bankruptcy of the assigned debtors the rules in relation to clawback actions, pursuant to Article 67 of the Bankruptcy Law, do not apply to payments made by the assigned debtors to the issuer; and

(v) in the event of bankruptcy of the assignor, the one-year and six-month terms for the exercise of the clawback action
pursuant to Article 67 of Bankruptcy Law are reduced to six months and three months respectively.

7.2 Securitisation Entities. Does Italy have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

(a) Pursuant to Article 3 of the Italian Securitisation Law, securitisation companies shall have as their sole corporate purpose the carrying out of one or more securitisation transactions. With reference to the segregation of assets, please refer to question 7.1 (ii) above.

(b) SPVs must be incorporated as a joint stock company or limited liability company (please refer to Article 3 of the Italian Securitisation Law).

(c) Further, requirements for shareholder status are provided under Article 19 of the Italian Banking Act. Directors shall meet the honour, professionalism and independence requirements provided under Articles 25 and 26 of the Italian Banking Act.

7.3 Non-Recourse Clause. Will a court in Italy give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

Italian courts may give effect to a limited recourse provision, even if the contract’s governing law is the law of another country, provided that such provision does not constitute a limitation of liability prohibited under Article 2740, paragraph 2 of the Italian Civil Code.

7.4 Non-Petition Clause. Will a court in Italy give effect to a contractual provision (even if the contract's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

(a) - (b) An Italian court may give effect to a non-petition clause (pursuant to which a creditor of the issuer agrees not to institute against or adhere in instituting against the issuer any bankruptcy, reorganisation, arrangement, insolvency or liquidation proceedings or join as a party any of these proceedings already instituted) only to the extent that it would give rise to the right to claim for damages in case of breach but, in general, it would not prevent the petition filed in breach of such provision from being deemed to have been validly filed.

7.5 Priority of Payments "Waterfall". Will a court in Italy give effect to a contractual provision (even if the contract's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

The order of priority of payments contained in contractual provisions, under which, inter alia, some parties accept to subordinate their rights to the rights of other creditors of the issuer, would be valid among the parties under Italian law. In any event, should the receiver or bankruptcy trustee of the debtor disregard the subordination provisions contained in waterfall, it should pay all amounts due to the creditors (or their delegates), who might then have to comply with the provisions regarding priority of payments.

7.6 Independent Director. Will a court in Italy give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In general, resolutions that have not been adopted in compliance with the by-laws may be challenged by the board of auditors and by the directors who were not present or dissented (i.e. an independent director who has not expressed his vote) within ninety days from the date of the resolution (Article 2388, paragraph 4, of the Italian Civil Code). With reference to insolvency procedures, please note that directors are obliged to comply with the duties provided by the Italian Bankruptcy Law.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Italy, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Italy? Does the answer to the preceding question change if the purchaser does business with other sellers in Italy?

In general, all companies carrying out financial activities in Italy shall be enrolled in the general register held by the Bank of Italy, pursuant to Article 106 of Italian Banking Act.

If the purchase takes place in the context of a securitisation transaction, please refer to questions 7.1 and 7.2 above.

The answer does not change if the purchaser does business with other companies.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Pursuant to Article 2, paragraph 6 of the Italian Securitisation Law, the entity which carries out servicing duties in favour of the securitisation company has to be a bank or a financial institution enrolled in a special register provided under Article 106 of the Italian Banking Law.

8.3 Data Protection. Does Italy have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

In Italy, data is to be treated in accordance with the security measures provided under Legislative Decree No. 196 of 30 June 2003 ("Data Protection Law"), which applies both to consumers and enterprises.
8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Italy? Briefly, what is required?

Transactions with consumers shall be carried out by entrepreneurs in accordance with the provisions set forth in Consumers’ Code, which provides certain rules aimed at protecting the weaker party.

8.5 Currency Restrictions. Does Italy have laws restricting the exchange of Italy’s currency for other currencies or the making of payments in Italy’s currency to persons outside the country?

There are no provisions limiting the exchange of currency.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Italy? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

As a principle, but subject to certain exceptions, no withholding tax is levied on payments of commercial receivables. However, as a general rule, the interest payments made by an Italian resident (other than an individual) to a foreign entity are subject to withholding tax. The rate can vary in relation to the location of the purchaser.

9.2 Seller Tax Accounting. Does Italy require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

According to Article 101, paragraph 5 of the Italian Income Tax Code, losses on receivables are deductible as long as they derive from definite and determined elements.

In any case, such condition is satisfied if a small amount (as quantified by the same Article 101) of receivables is sold and a period of six months from the date of payment has elapsed. For companies adopting the International Accounting Standards (IAS/IFRS), the conditions for the application of the deductions are met in case of de-recognition of receivables.

In case of a sale of receivables without recourse, based on Italian Accounting Principles, the assigned receivables must be removed from the accounts of the seller and, for tax purposes, a taxable gain/deductible loss, equal to the difference between the book value and the selling price, if any, must be recorded.

In case of a sale with recourse, the seller can either keep the receivables in the accounts or remove them mentioning the risk exposure related thereto in the memorandum accounts. From a tax point of view, losses, if any, cannot be deducted if such losses do not meet the requirements set forth in Article 101 and mentioned above.

Companies required to comply with the IAS/IFRS must apply the criteria set forth by IAS 39, according to which, in case the seller retains control of the financial assets following the transfer of the receivables, such financial assets must be recognised in the seller’s accounts to the extent of the seller’s continuing involvement in the same assets. This implies that the seller continues to account the receivables also for tax implications arising therefrom.

It is worth mentioning that IAS/IFRS have been implemented in Italy through Legislative Decree No. 38 of 28 February 2005, whereby listed companies, insurance companies, banks and companies issuing debt instruments to the public must draw up the consolidated balance sheet according to the IAS as from 1 January 2005. The companies mentioned above must draw up an operating balance sheet in accordance with the IAS/IFRS from 1 January 2006.

Concerning issuers incorporated pursuant to Law 130, the Bank of Italy has issued a regulation on 14 February 2006 confirming, broadly speaking, the off-balance sheet treatment of securitisation transactions done pursuant to Law 130 in the accounts of a Law 130 issuer.

From a fiscal perspective, if the seller does not remove from their books the financial assets sold, it is not entitled to deduct any capital loss arising from the sale.

9.3 Stamp Duty, etc. Does Italy impose stamp duty or other documentary taxes on sales of receivables?

As a rule, sales of receivables made in the context of a securitisation transaction shall be subject to registration tax (imposta di registro) at a fixed amount (currently Euro 168). In addition, stamp duty (imposta di bollo) shall apply at a fixed amount (currently Euro 14.62) for each four pages of the relevant document.

9.4 Value Added Taxes. Does Italy impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

In Italy, as a matter of principle, sales of goods or services for consideration are subject to VAT. The sale of receivables shall be subject to VAT if carried out in the context of a financial transaction and if made for consideration; nevertheless, should that be the case, the sale would be VAT exempt pursuant to Article 10 paragraph 1 of the Presidential Decree No. 633 of 26 October 1973.

As to the services rendered by the collection agent (servicer), they are subject to Italian VAT.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

In Italy, tax liabilities are not joint and several, unless the law provides otherwise.

With regard to stamp duty and registration tax, the seller and the purchaser are jointly liable for the payment, if due.

In certain circumstances the purchaser shall be obliged to issue a VAT invoice and/or to pay the relevant VAT directly to the tax authorities if the seller fails to do so.

Pursuant to certain articles of the Italian Civil Code, general or special liens are granted to the Tax Authorities for claims for taxes and duties.
9.6 Doing Business. Assuming that the purchaser conducts no other business in Italy, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Italy?

In this respect a case-by-case analysis should be performed in order to determine whether or not a permanent establishment issue may arise.

In general terms the purchase of the receivables and the subsequent activities do not meet the concept of permanent establishment. However, it is worth mentioning that the recent practice of the Italian Tax Authorities is more aggressive than in the past with regard to the permanent establishment of foreign entities. Therefore the purchaser must be careful in order to exclude any relevant relationship with the Italian territory. In this context – even on the basis of the recent jurisprudence – it is advisable to take into account the real level of autonomy of the collection agent and other subject (other than the purchaser) involved in the transaction.

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Chapter 24

Japan

Nishimura & Asahi

Hajime Ueno

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

It is not necessary for the sale of goods or services to be evidenced by a formal contract, so long as there is a legally binding, effective and valid contract, whether oral or implied. Whether invoices alone would be sufficient as evidence of the existence of an enforceable debt obligation would depend on the facts of each case and would be determined by the courts. A contract can be determined to exist from evidence including: the behaviour of the parties; past relationships; or commercial customs.

1.2 Consumer Protections. Do Japan laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) There are usury laws that restrict the rate of interest on loans (which can include various forms of credit extension), namely the Interest Rate Restriction Law (the “IRR Law”) and the Law for Control of Acceptance of Contributions, Money Deposit and Interest, etc. (the “Contributions Law”). The IRR Law provides that a contractual clause providing for interest on a loan at a rate exceeding a certain prescribed rate (described below) is null and void with respect to the portion exceeding such rate. Significantly, fees, default interest and other amounts received by a lender in connection with the loan will be treated as interest payments for the purpose of calculating the rate of interest.

<table>
<thead>
<tr>
<th>Principal</th>
<th>Maximum Rate of Interest (per annum)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 100,000 Yen</td>
<td>Equal to or under 20 per cent</td>
</tr>
<tr>
<td>From 100,000 Yen to 1,000,000 Yen</td>
<td>Equal to or under 18 per cent</td>
</tr>
<tr>
<td>1,000,000 Yen or more</td>
<td>Equal to or under 15 per cent</td>
</tr>
</tbody>
</table>

Under the current Contributions Law, no person in the money lending business may charge interest at a rate exceeding 20 per cent per annum. Charging or receiving interest at a rate in excess of such rate is subject to criminal penalties. Similarly with the IRR Law, in calculating the interest rate, any payment that the lender receives in connection with the lending will be deemed to be part of the interest payment. The Moneylenders Law is a regulatory statute governing non-bank finance companies. The Law requires registration of those who engage in the business of lending money, and regulates various lending practices, including marketing and collection practices, as well as the rate of interest charged on loans extended by moneylenders. Lastly, a prohibitively high rate of interest on (or interest on late repayments of) credit or other kinds of receivables may possibly be determined as void due to public policy reasons pursuant to the general Civil Code.

(b) There is a statutory right to interest on late payments; specifically, the general Civil Code provides that, unless otherwise agreed by the parties, interest will accrue following a late payment of a monetary obligation at a rate of five per cent per annum (six per cent per annum, in cases of monetary obligations arising out of commercial conduct, as provided under the Commercial Code).

(c) For certain consumer contracts such as instalment sales agreements (i.e., sale and purchase agreements for which payments of purchase amounts are in instalments) in respect of certain types of products (including, without limitation, life insurance policies purchased outside of the insurance company’s premises), the Instalment Sales Law (the “ISL”) provides consumers with rights to cancel contracts during the cooling off period mandated by the law.

(d) The ISL also provides consumers with protection against provisions providing for the business operator’s right to terminate the contract or to declare that the consumer’s obligation to pay all unpaid instalments has become immediately due and payable even if the consumer does not pay an instalment, unless the business operator makes a demand against the consumer in writing to pay the instalment within a period prescribed in such written demand (which must be a reasonable period and may not be less than twenty days from such written demand) and the consumer fails to so pay the instalment within such period. In addition, the Consumer Contracts Law (the “CCL”) provides, among other things, consumers with rights to rescind consumer contracts, for example, if the consumer had mistakenly manifested his/her intention to enter into the contract as a result of any misrepresentation by the business operator (who is the counterparty to the consumer contract) with respect to material matters such as quality, purpose and other characteristics of goods, rights, services, etc., of such consumer contract.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

As a matter of practice, when the government or a governmental...
agency enters into a receivables contract, the contract would likely include a provision that prohibits transfers/assignments of rights thereunder by the counterparty without the prior consent of the government or the governmental agency, as the case may be. Also, such receivables contract may include a provision requiring that no third party be appointed as a collection serviccer without the prior consent of the government. Therefore, although there is no specific statutory requirement, consent of the government or the governmental agency would likely be contractually required for the sale and/or collection of receivables.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Japan that will determine the governing law of the contract?

The Application of Laws (General) Act (the “ALGA”) which came into effect on 1 January 2007, provides that if the parties to a contract do not specifically agree on a choice of law, the law of the jurisdiction having the closest relevance with the contract will govern the contract. However, it is generally assumed that a Japanese court will still follow a Supreme Court ruling, made prior to the introduction of the Act, to the effect that courts should first determine if the parties had implicitly agreed on the choice of law before applying the principle above. The Act also stipulates that if the contracting parties had not specifically agreed on a choice of law, and if the contract obligates a party to undertake a characteristic performance, then the law of such party’s residence (or primary office) will be presumed to be the law of the jurisdiction having the closest relevance.

2.2 Base Case. If the seller and the obligor are both resident in Japan, and the transactions giving rise to the receivables and the payment of the receivables take place in Japan, and the seller and the obligor choose the law of Japan to govern the receivables contract, is there any reason why a court in Japan would not give effect to their choice of law?

In such a case, it would be very unlikely for a court not to uphold the parties’ choice of law, at least judging from the published court decisions; provided, however, if the subject of the receivables contract is a moveable, the ownership of which is to be registered, and which is located outside of Japan, then under the ALGA, the law of the jurisdiction in which the movable is located will govern the matters relating to the transfer of ownership.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Japan but the obligor is not, or if the obligor is resident in Japan but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Japan give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Under the ALGA, parties to a contract are allowed to choose the governing law to be applied to their contractual obligations. Accordingly, the seller and the obligor may choose a foreign law to govern the receivables contract. However, if the application of the chosen law would result in a situation that would be against the public welfare or interests of Japan, then a court would not apply the chosen law as the governing law. In addition, different sets of rules under the ALGA are applied to consumer contracts to protect the interests of consumers. For example, if the obligor is a consumer (as defined in the ALGA) and the seller is a business operator (also as defined in the ALGA), then the consumer (i.e., the obligor) may demand that the law of the jurisdiction in which he/she resides be the governing law.


Yes. The Convention came into effect in Japan on 1 August 2009.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Japan’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Japan’s laws or foreign laws)?

The ALGA does not specifically require that the sale agreement/contract under which receivables are sold be governed by the same law as the law governing the receivables themselves. However, under the ALGA, the “effects of a transfer” in terms of a transfer of a receivable (as opposed to contractual agreements stated in the sale agreement or surrounding the sale) against the obligor and other third parties are to be governed by the law governing the receivable itself, as noted in question 3.2 below.

3.2 Example 1: If (a) the seller and the obligor are located in Japan, (b) the receivable is governed by the law of Japan, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Japan to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Japan, will a court in Japan recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Under the ALGA, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself. Therefore, a Japanese court would determine the effects of the transfer resulting from the sale of the receivables (e.g., whether the receivables are effectively transferred) on the basis that Japanese law is the governing law. Thus, in this “Example 1” case, courts in Japan will recognise the sale as being effective against the seller, the obligor and other third parties.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Japan, will a court in Japan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

The ALGA does not take into account the requirements of the law of the obligor’s country or the purchaser’s country; and as noted in question 3.2 above, the effects of a transfer of a receivable against
the obligor and other third parties are governed by the law governing the receivable itself.

3.4 Example 3: If (a) the seller is located in Japan but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Japan recognise the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Japan’s own sale requirements?

As noted in question 3.2 above, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself; therefore, the sale of the receivable needs to be, under the ALGA, governed by the law of Japan. Thus, unless the sale is governed by the law of Japan, a court in Japan will not recognise the sale as being effective against the seller and other third parties. However, this does not necessarily mean that the choice of law under the sale agreement will immediately be deemed void, since the effects of rights and obligations arising directly out of the sale agreement (e.g., whether an act of the seller would constitute a breach of contract giving rise to an indemnification obligation of the seller) would be determined in accordance with the law chosen as the governing law under the agreement, subject to the public welfare or interest doctrine described in question 2.3 above.

3.5 Example 4: If (a) the obligor is located in Japan but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Japan recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Japan’s own sale requirements?

As noted in question 3.2 above, the effects of a transfer of a receivable against the obligor and other third parties are governed by the law governing the receivable itself; therefore, the sale of the receivable needs to be, under the ALGA, governed by the law of Japan. Thus, unless the sale is governed by the law of Japan, a court in Japan will not recognise the sale as being effective against the seller and other third parties. However, this does not necessarily mean that the choice of law under the sale agreement will immediately be deemed void, since the effects of rights and obligations arising directly out of the sale agreement (e.g., whether an act of the seller would constitute a breach of contract giving rise to an indemnification obligation of the seller) would be determined in accordance with the law chosen as the governing law under the agreement, subject to the public welfare or interest doctrine described in question 2.3 above.

4 Asset Sales

4.1 Sale Methods Generally. In Japan what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Under the current system, the customary method for a seller to sell receivables is to enter into a sales agreement with the purchaser in which the subject receivables need to be specified, and the sale be perfected through one of the methods described in question 4.2 below. In some cases the continuous sales method is adopted. The terminology in the Japanese language is “baibai” (a simple translation would be “sale”) or “joto” (a simple translation would be “assignment”).

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The perfection of a sale of receivables is generally made by one of the following methods:
(a) the seller delivering notice to the obligors, or the seller or purchaser obtaining consent from the obligors, which notice or consent must bear an officially certified date (kakutei-hizuke) by means prescribed under law in order to perfect against third parties; or
(b) where the seller is a corporation, the seller registering the sale of receivables in a claim assignment registration file in accordance with the Law Prescribing Exceptions, Etc., to the Civil Code Requirements for Perfection of Transfers of Movables and Receivables (the “Perfection Exception Law”).

Provided one of the methods noted above is duly taken, there are no additional formalities required for perfection against subsequent purchasers.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

(i) Promissory notes

Under the Promissory Notes Law, the general method of sale and perfection against the obligor and third parties is by the seller endorsing the promissory notes and delivering the same to the purchaser.
(ii) Consumer loans

While there are no additional or different requirements for perfection of sales of consumer loans, see question 8.3 for regulations regarding sales of loans extended by moneylenders regulated under the Moneylenders Law (nevertheless, the regulations apply not only to consumer loans but to all loans (including mortgage loans) extended by a moneylender).

(iii) Mortgage loans

For the perfection of a sale of a loan secured by a hypothec (teito-ken) or umbrella hypothec (ne-teito-ken), the following will be necessary as additional requirements to those described in questions 4.1 and 4.2:

(a) In case of a loan secured by a hypothec:
   
   In order for the hypothec to be concurrently transferred to the purchaser with the sale of a loan (secured by the hypothec), no additional action is necessary other than the requirement for the valid and effective sale of the loan itself (zuihansei). For perfection of the transfer of the hypothec as a result of the sale of the loan, the transfer of the hypothec needs to be registered through a supplemental registration (fuki-toki) in the real estate registry (however, such registration is generally believed to be unnecessary to perfect against a third party who is a transferee of the hypothec together with the loan secured thereby).

(b) In case of a loan secured by an umbrella hypothec:
   
   In order for a loan to be transferred together with an umbrella hypothec (or the hypothec resulting from crystallisation of the umbrella hypothec), and for such transfer to be perfected, either of the following methods needs to be used:
   
   (x) For an effective transfer of an umbrella hypothec without crystallisation, the obligor or any other party who created the umbrella hypothec must consent to the transfer (and consent to amend the scope of obligations secured by the umbrella hypothec might also be necessary depending on the terms thereof). For perfection of the transfer of an umbrella hypothec without crystallisation, the transfer needs to be registered through a supplemental registration (fuki-toki) in the real estate registry.

(y) For an effective transfer of a loan with a hypothec resulting from the crystallisation of an umbrella hypothec that originally secured the loan, the obligations secured by such umbrella hypothec need to be crystallised (kabatei) in accordance with the general Civil Code prior to the sale becoming effective (if not crystallised, and if the consent described in (x) above is not obtained, the relevant loan will be transferred as an unsecured loan). For perfection of the transfer of the hypothec (occurring together with the transfer of the loan secured thereby) resulting from the crystallisation, the requirement described in (a), above, applies.

(iv) Marketable debt securities

While there is no legal concept equivalent to “marketable debt securities” or any legal distinction between marketable securities and non-marketable securities under Japanese law, we will focus on the sale and perfection of Japanese government bonds ("JGBs") and bonds issued by corporations. The requirements for sale and perfection of these securities depend on their type.

(a) In case of JGBs:

   (A) If in bearer form with physical certificates (mukimei kosai shouken):

   For effective sale and perfection, the seller and purchaser must agree to sell and purchase the JGBs and the seller should deliver the physical certificates to the purchaser. In general, there is no prohibition on the transfer of bearer JGBs.

   (B) If registered JGBs (touroku kokusaiken):

   For perfection against third parties as well as the government, the transfer needs to be registered in the JGB registry at the Bank of Japan in accordance with the Law Concerning Book-Entry Transfer of Corporate Bonds, Etc. (the “Transfer Law”).

(b) Corporate Bonds:

   (A-1) If in bearer form with physical certificates (mukimei shasai ken):

   Under the Corporations Act, no transfer will be effected without the physical delivery to the purchaser of the certificate in case of certificated bonds.

   (A-2) If in non-bearer form with physical certificates (kimei shasai ken):

   The same as (A-1) above, under the Corporations Act, no transfer will be effected without the physical delivery to the purchaser of the certificate in case of certificated bonds. In addition, in cases of non-bearer bonds issued pursuant to the Corporations Act, in order to perfect the transfer against third parties and against the issuer company, the purchaser’s name and address need to be recorded in the bond registry (shasai genbo) in accordance with the Corporations Act.

   (B) Book-entry bonds under the Transfer Law (furikae shasai):

   For sale and perfection against the issuer company and third parties, the amount of the book-entry bonds assigned to the purchaser as a result of the sale needs to be entered into the purchaser’s account book in accordance with the Transfer Law.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Where the receivables contract prohibits a sale of the receivables thereunder without the consent of the obligor, the consent of the obligor will be required. Therefore, in such a case, naturally, a notification to the obligors would be required as a matter of fact. Otherwise, whether or not the sale is effective against the obligors is a question of perfection against the obligors. That is, if the sale is perfected against the obligors, then the sale is an effective sale against the obligors. Once the sale of receivables is perfected against the obligors, for example, the purchaser will be allowed to enforce the debts directly against the obligors and the obligors will be required to pay the purchaser rather than the seller. In order to
perfect a sale of a receivable against the obligor thereof, one of the following methods needs to be used:

(a) the seller must deliver a notice to the obligor or obtain consent from the obligor (in contrast to the perfection against third parties, there is no need for the notice/consent to bear an officially certified date (kakutei-hizuke)); or

(b) where the assignment of the receivables is perfected against third parties by registration under the Perfection Exception Law, the seller or purchaser must either use the method noted above in (a) or notify the obligor of the sale of the receivables by delivering a registered certificate (touki jikou shoumeteisho), or obtain consent from the obligor thereby.

Where the receivables contract prohibits a sale of the receivables thereunder without the consent of the obligor, the consent of the obligor will be required (the question is whether or not the contract permits assignments rather than whether the contract permits assignments). Otherwise, whether or not the sale is effective against the obligors is a question of perfection against the obligors.

There is no legal limitation regarding the purchaser notifying the obligor of the sale of receivables after the insolvency of the seller or the obligor; in fact, the customary contractual arrangement in securitisation transactions is that the purchaser will be allowed to notify the obligor of the sale once the seller or the obligor becomes insolvent.

Unless a sale of a receivable is perfected, the obligor will retain set-off rights and other obligor defences, therefore, perfection would be required to prevent those defences. For the avoidance of doubt, set-off rights and other defences that preceded the perfection would remain effective (with the exception of a waiver by the obligor).

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

With respect to the form of the notice, see questions 4.2 and 4.4. As for the time limit for delivering a notice, while notice could be delivered after an insolvency proceeding has commenced against the obligor or the seller, such notice could be voided - if the notice had been delivered with the knowledge of either the fact that the obligor ceased payments or the fact that the petition for the commencement of the insolvency proceedings had been filed - by avoidance rights of insolvency trustees, unless the delivery had been made within 15 calendar days from the sale (as opposed to the commencement date of the insolvency proceedings). While a notice can be applied to future receivables, future receivables do need to be specified in a certain manner for the notice to be legal and valid (see question 4.10).

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Japan? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Japan recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

There is no general restriction on receivables contracts prohibiting the sale or assignment of receivables, even as between commercial entities. As prohibitions on the sale or assignment provided under receivables contracts are recognised, the seller will be liable to the obligor if any damage is incurred by the obligor when the seller breaches the prohibition. Provided, however, that a sale of a receivable, the receivables contract in respect of which expressly prohibits assignment thereof, will not constitute a valid and effective transfer unless the purchaser, in the absence of both the knowledge of such prohibition and gross negligence in having no knowledge of the prohibition, purchased the receivables from the seller. Therefore, in cases where no transfer will be given effect, the obligor will usually incur no damage as a result of the sale.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale agreement must specifically identify the receivables in order for the receivables to be validly sold. There is no minimum or specific legal requirement in identifying the receivables and it will vary depending upon the types of receivables and receivables contracts; receivables can be identified by information such as obligor names, amounts of the receivables, invoice numbers, the contract dates and/or the terms of the receivables. For so long as the receivables sold under a sales agreement are sufficiently identified, the receivables sold under the agreement do not need to share objective characteristics.

Depending on the nature of the seller, it could be possible to construe that identification of receivables is sufficient if the seller sells all of its receivables; however, that this will not be the case if the seller’s receivables include receivables that are restricted from sale or assignment; also, if the sale includes the sale of future receivables, the sale may be deemed void. The same will apply with respect to the case where the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors. Please see question 4.9 for the assignability of future receivables.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Any transaction could be recharacterised based on its economic characteristics regardless of the parties’ designation of a transaction as a sale or any statement of such intent, on the other hand, economic characteristics of a sale will not prevent the sale from being perfected, unless the characteristics hinder the nature of the transaction and result in recharacterisation thereof. In other words, under Japanese law, provided a transaction is not recharacterised as a loan or any other transaction, economic characteristics will not prevent a sale from being perfected. On the other hand, any
characteristics (which may include the seller retaining too much credit risk, interest rate risk or control over the receivables) that is inconsistent with the characteristics of sales transactions may result in recharacterisation; in this connection, retaining a right of repurchase/redemption could be viewed as generally making the transaction as being susceptible to recharacterisation.

### 4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

It is possible for the seller to agree to continuous sales of receivables in an enforceable manner (at least prior to its insolvency), however, such continuous sales would be subject to the insolvency officials’ right to rescind.

### 4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Following a Supreme Court case ruling in 1999, the general belief is that it is possible for the seller to commit to sell future receivables for so long as the receivables are sufficiently specified and identified (by, for example, the obligors thereof, the transactions from which the receivables are generated, the amounts of the receivables and/or the dates on which receivables are respectively generated); provided that the sale of the receivables, in whole or in part, may be deemed or determined to be void due to a contradiction with the public welfare/interest or for any other reasons and there also is a possibility of the sale of future receivables being subject to rights of insolvency officials to rescind, especially with regard to receivables arising after the seller’s insolvency.

### 4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Provided the transfer of the receivables is enforceable and perfected against third parties, it is generally believed that a related security (other than an umbrella security interest such as an umbrella hypothec) securing the transferred receivables will also automatically be recognised as being concurrently transferred in a perfected manner (see question 4.3 above). Provided, however, with respect to certain security interests that can be registered such as a hypothec, the concurrent transfer of the hypothec will not be perfected against a third party that acquires the related security (without acquiring the obligation secured thereby) unless the concurrent transfer is separately perfected; for example, in the case of a hypothec, perfected by registration in the relevant real estate registry through a supplemental registration.

As for umbrella securities, crystallisation thereof will be required in order to provide the purchaser with the benefits of the security (although following a crystallisation, an umbrella security will no longer be an umbrella security but a regular security) or obtain the consent of the obligor or any other party who granted the security in order to transfer the umbrella security as an umbrella security to the purchaser.

## 5 Security Issues

### 5.1 Back-up Security. Is it customary in Japan to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Under Japanese law, the methods to perfect a sale of receivables and methods to perfect the creation of a security interest over receivables are basically the same. Therefore, it is not customary in Japan to take a “back-up” security interest. While there have been arguments about taking a “back-up” security interest in order to protect the interest of the purchaser in the event that the sale is recharacterised as a financing rather than a sale (note that the purpose is different from the term “back-up” for a failure to perfect a sale), since the creation of a “back-up” security interest would seem to contradict the parties’ intention to effect a true sale and because, even if recharacterised, transactions would likely be recharacterised as secured lending with a perfected security, it is generally assumed that the taking of a “back-up” security interest would not add much protection, but, at the same time, run the risk of working against the true sale nature of the transactions and, therefore, parties customarily do not create any “back-up” security interest.

### 5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Japan, and for such security interest to be perfected?

Seller security is not applicable in Japan.

### 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Japan to grant and perfect a security interest in purchased receivables governed by the laws of Japan and the related security?

Under Japanese law, there is no simple way to grant a security over “all assets” of the purchaser. The purchaser must grant specific security over each specific asset class/type separately. Therefore, if receivables constitute a part of the purchaser’s “all assets”, then to effect and/or perfect a security interest over such receivables, the following formalities must be complied with:

For granting a security interest in receivables, a “pledge” (shichiken) or a “security assignment” (jyoto-tampo) is usually used in Japan.

(i) **Pledge**

In order to effectively pledge receivables to the creditor, the following need to be satisfied:

- while there is no formality requirement for a pledge agreement, in the agreement, the same as sales of receivables, receivables to be pledged must be specified, and assignments thereof must not be prohibited under the relevant receivables contracts; and
- the pledgor must deliver to the pledgee the instruments evidencing such receivables, if such instruments need to be delivered in order to effect an assignment of such receivables.
In order to perfect the creation of the pledge against third parties and obligors, one of the following methods needs to be undertaken:

(a) the pledgor must deliver notice to the obligors, or the pledgor or pledgee must obtain consent from the obligors, which notice or consent must bear an officially certified date (kakutei-hizuke) by means prescribed under law in order to perfect against third parties (if no officially certified date is affixed, then the creation of the pledge will still be perfected against the obligors but not against third parties); or

(b) if the pledgor is a corporation, the pledgee must register the creation of the pledge in a claim assignment registration file in accordance with the Perfection Exception Law.

(ii) Security assignment

In order to effectively assign receivables for security purposes, the following need to be satisfied:

- while there is no formality requirement for a security assignment agreement, in the agreement, the same as with sales of receivables, receivables to be assigned for security purposes must be specified, and assignments thereof must not be prohibited under the relevant receivables contracts; and

- the same as with pledges of receivables, the assignor must deliver to the assignee the instruments evidencing such receivables, if such instruments need to be delivered in order to effect an assignment of such receivables.

In order to perfect the creation of the security assignment against third parties and obligors, one of the following measures needs to be undertaken:

(a) the assignor must deliver notice to the obligors, or the assignor or assignee must obtain consent from the obligor, which notice or consent must bear an officially certified date (kakutei-hizuke) by means prescribed under law in order to perfect against third parties; or

(b) if the assignor is a corporation, the assignor must register the assignment of receivables in a claim assignment registration file in accordance with the Perfection Exception Law.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

(i) Insurance policies

There is no additional or different requirement specifically applicable only to insurance policies under Japanese law. Provided, however, that for those insurance policies that are payable to order (i.e., those that fall under the definition of sashizu-saiken), endorsement will be required in order to effect and perfect the transfer.

(ii) Promissory notes

Under the Promissory Notes Law, the general method of granting security interests on promissory notes and perfection against the obligor and third parties is by the grantor endorsing the promissory notes and delivering the same to the grantee.

(iii) Consumer loans

Unlike the sale of (consumer) loans, regulations regarding sales of loans extended by moneylenders regulated under the Moneylenders Law (see question 8.3) do not apply to the grantee of the security interests on (consumer) loans, even if the loans are extended by a moneylender, unless and until the security interests are foreclosed.

(iv) Mortgaged loans

When a security interest is validly and effectively granted over, or in, a loan that itself is secured by a hypothec (teito-ken) (but not in the case of an umbrella hypothec (ne-teito-ken)), the grantee will automatically benefit from the hypothec as the security interest will grasp the loan as a secured loan without any additional or different requirement (zuhansetu). However, this does not mean that the grantee would be entitled to directly enforce/foreclose on the hypothec or umbrella hypothec. The security interest granted over, or in, the loan secured by the hypothec or umbrella hypothec must first be enforced/foreclosed. Thereafter, if the grantee acquires the loan secured by the hypothec or umbrella hypothec himself/herself as a result of such enforcement/foreclosure, then the grantee will be able to enforce/foreclose on the hypothec or umbrella hypothec (but only if the loan is due and payable). In order to perfect the interest the grantee acquires as a result of the granting of the security interest over or in the loan secured by the hypothec against third parties who gain interest in the hypothec after the granting of the security interest, a registration (if the security interest is a pledge, in the form of an amendment registration and if the security interest is a security assignment, in the form of a supplemental registration) needs to be made in the relevant real estate registry (however, it is generally believed that the grantee of the security interest in a
In order to pledge corporate bonds and to perfect such pledge, the requirements for the granting/creation of security interests in respect of these securities and perfection thereof depend on the form of the JGBs and the bonds.

(a) In case of JGBs:

In order to pledge JGBs and to perfect such pledge, the following is required:

(A) If in bearer form with physical certificates (mukime kokusai shouken):

- the pledgor and the pledgee must agree on the creation of the pledge of JGBs and the pledgor must deliver the physical certificates to the pledgee; and
- for continued perfection against third parties, the pledgee must continuously keep custody of the physical certificates.

(B) If registered JGBs (toroku kokusai):

An effective pledge of registered JGBs will arise if the seller and the purchaser agree to the creation of the pledge, provided that the JGBs do not prohibit the transfer thereof. For perfection against third parties as well as the government, the transfer needs to be registered in the JGB registry at the Bank of Japan in accordance with the Law Regarding Japanese Government Bonds and rules promulgated thereunder.

(C) If in book-entry form under the Transfer Law (furikae kokusai):

For the creation of a pledge over such JGBs and perfection against the government and third parties, the amount of the JGBs pledged to the pledgee needs to be entered into the pledgee’s account book in accordance with the Transfer Law.

The requirements for the effective granting of a security assignment of JGBs and perfection thereof are basically the same as the requirements for the effective sale and perfection thereof as outlined in question 4.3 above.

(b) Corporate bonds:

In order to pledge corporate bonds and to perfect such pledge, the following is required:

(A-1) If in bearer form with physical certificates (mukime shasai ken):

Under the Corporations Act and the general Civil Code, no creation of a pledge will be effected without the physical delivery to the pledgor of the certificate in case of certificated bonds issued pursuant to the Corporations Act. For continued perfection against third parties, the pledgor must continuously keep custody of the physical certificates.

(A-2) If in non-bearer form with physical certificates (kimei shasai ken):

The same as (A-1) above, under the Corporations Act and the general Civil Code, no pledge will be effected without the physical delivery to the pledgor of the certificates in case of certificated bonds issued pursuant to the Corporations Act. In addition, in cases of non-bearer bonds issued pursuant to the Corporations Act, in order to perfect the transfer against third parties and against the issuer company, the pledgee’s name and address must be recorded in the bond registry (shasai genbo) in accordance with the Corporations Act.

(B) If book-entry bonds under the Transfer Law (furikae shasai):

In order to pledge book-entry bonds and to perfect against the issuer company and third parties, the amount of the book-entry bonds pledged to the pledgee must be entered into the pledgee’s account book in accordance with the Transfer Law.

The requirements for the effective granting of a security assignment of corporate bonds and perfection thereof are basically the same as the requirements for the effective sale and perfection thereof as outlined in question 4.3 above.

5.6 Trusts. Does Japan recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, trusts are recognised under Japanese law. In fact, a statute entitled the Trust Law governs and sets the statutory rules (some of which are mandatory rules rather than default rules).

5.7 Bank Accounts. Does Japan recognise escrow accounts? Can security be taken over a bank account located in Japan? If so, what is the typical method? Would courts in Japan recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Japan?

Escrow arrangements may take several forms under Japanese law as there is no legal concept of “escrow” per se. A trust would be one of the major legal forms that could be utilised for an escrow arrangement.

While a security interest can be created over rights of the holder of a bank account owing money to a bank in Japan, it is not a security over the bank account per se; rather, it is a security over a monetary claim - a claim to receive refund of the deposit - against the bank. Also, there is an argument that a security interest created over the rights of the holder of a bank account would become invalid or unperfected each time the balance of the account changes.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

No. Since, as described in question 5.7 above, a security interest over a bank account is a security over a monetary claim against the bank rather than a security over the account per se, the secured party will not control all cash flowing into the bank account from the enforcement forward. Technically, it may be possible -although there is, also as described in question 5.7 above, an argument that a security interest created over the rights of the holder of a bank account would become invalid or unperfected each time the balance of the account changes- to create a security interest purporting to cover any and all cash flowing into a bank account, formal foreclosure of such security would need to be made with a specific amount of deposit.
5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

That may be possible, but there is an argument to the contrary (see questions 5.7 and 5.8 above for more detail).

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Japan’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action?”). Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Under Japanese law, there is no system or mechanism equivalent to an automatic stay. Neither the filing of the petition for insolvency proceedings itself, nor the commencement of such proceedings, automatically prohibits creditors from exercising or enforcing their rights; however, Japanese insolvency courts will customarily issue stay orders as to payments on, or performance of, obligations of the insolvent. Also, upon and after the commencement of the insolvency proceedings, the creditors to the insolvent will be subjected to such proceedings and will be prohibited from exercising or enforcing their rights outside such proceedings; however, secured creditors will basically be allowed to enforce/foreclose on their security interest if the insolvency proceeding is either a bankruptcy proceeding under the Bankruptcy Code or a rehabilitation proceeding under the Civil Rehabilitation Law, in each case subject to certain rights of the insolvency official to extinguish the security interest and/or to stay the foreclosure process of the security interest.

More importantly, if the sale of the receivables prior to the commencement of the insolvency proceeding is perfected, and for so long as the sale is not recharacterised as a lending transaction rather than a true sale, the purchaser will not be a creditor to the insolvent in connection with the purchased receivables and, therefore, will have the rights and ability to collect, transfer or otherwise exercise ownership rights over the purchased receivables (note, however, that whether or not the purchaser will have the ability to terminate a servicing agreement (entered into with the seller, if any, in order to let the originator/seller service the receivables) upon the seller becoming subject to the insolvency proceeding is a separate question; if the servicing agreement cannot be terminated, the insolvent seller may remain entitled to collect the receivables, although the purchaser otherwise has the right and ability to collect the receivables).

Conversely, insolvency officials tend to challenge the true sale nature of securitisation transactions in an effort to preclude the purchaser from exercising ownership rights over the receivables and/or challenge that the purchaser may not terminate the servicing agreement, if any, so that the insolvency officials will remain in control of the collection procedures.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

If the sale of receivables is perfected and is a true sale, then the purchaser will not be prohibited from exercising its ownership rights over or other rights in respect of the purchased receivables (save for the uncertainty as to the termination of the servicing agreement).

To the contrary, if the sale is not perfected prior to the insolvency or if the sale is not a true sale, then the purchaser’s exercise of rights may be prohibited or restricted. Firstly, if the sale was a true sale but not perfected, then the insolvency official would effectively rescind the sale as a result of which the receivables would claw back to the insolvent’s estate. Furthermore, if the sale was not a true sale, then, irrespective of whether or not the transaction was perfected, the purchaser would be a creditor, as a result of which the purchaser’s ability to exercise its rights may be restricted by the insolvency proceedings (provided, that, as described in question 6.1, if the purchaser is deemed a secured creditor with a perfected security interest, and if the insolvency proceeding was either a bankruptcy proceeding or a rehabilitation proceeding, then the purchaser as a secured creditor would be entitled to enforce/foreclose on its security interest save for limited exceptions).

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Japan for (a) transactions between unrelated parties and (b) transactions between related parties?

Separately from insolvency officials’ right to avoid intentional acts of the insolvent that are harmful to, or that hinder, the insolvent’s creditors, the Bankruptcy Code, the Civil Rehabilitation Law and the Corporate Reorganisation Law provide for avoidance rights of insolvency officials with respect to acts of the insolvent that took place after the earlier of the suspension of payments in general and the filing of a petition for the commencement of the insolvency proceedings, subject to certain conditions such as a requirement that relates to the relevant creditor’s state of mind being satisfied; provided, however, that with respect to actions of the insolvent that relate to the granting of a security interest or discharging of an obligation of the insolvent, the insolvency official is entitled to avoid actions that took place after the earlier of the insolvent’s inability to pay its obligations and the filing of a petition for the commencement of the insolvency proceedings, subject to certain conditions such as a requirement that relates to the relevant creditor’s state of mind being satisfied (if the insolvent had no legal obligation to grant the security interest or to discharge its obligation at the time, then, the insolvency official may also avoid the relevant action provided it took place within 30 days before the insolvent’s inability to pay its obligations). Furthermore, any gratuitous act (including acts that are deemed to be gratuitous) that took place after the suspension of payments or the filing of a petition for the commencement of the insolvency proceedings or within six months before the earlier of the two can be avoided by the insolvency official.

(Please note that there are certain exceptions to the above described rules.)
In addition to the above, creditors of the insolvent may rescind actions of the insolvent that would prejudice creditors if certain conditions required under the general Civil Code are satisfied.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

No legal concept or theory that is equivalent or similar to the theory of substantial consolidation under the U.S. law exists under Japanese law. However, the insolvency official may be able to achieve a similar result through the application of the Japanese version of the piercing the corporate veil doctrine. That is, if the corporate veil of the purchaser is pierced, since all the assets of the purchaser would be deemed part of the seller’s (or its affiliate’s) assets, a similar result would be achieved. According to case law, a corporate veil will be pierced only when: (a) the legal entity is a sham; or (b) the legal entity is abused so as to avoid certain legal provisions. Note that, while there are certain factors that are to be taken into account in determining whether or not the doctrine should be applied, a recent court judgment suggested that the corporate veil of an SPC would not be pierced merely because it was a paper company.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Japan, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

In a bankruptcy proceeding, a rehabilitation proceeding or a reorganisation proceeding, the relevant insolvent official has the ability to rescind the insolvent’s obligations under a bilateral contract in respect of which both parties’ obligations are yet to be fulfilled.

If an insolvency proceeding is initiated prior to the transfer of receivables resulting from the sales thereof and if the sales price has not been paid, then the insolvency official will have the ability to rescind the sales agreement. To the contrary, a sales agreement of future receivables will not be rescinded simply because the receivables are future receivables. Sales of future receivables may be rescinded if the sale was through a continuous sale in connection with which the sales price for the future receivables has not been paid.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Japan establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes: the Law Concerning Liquidation of Assets (the “Securitisation Law”). The statute permits the setting up of a special purpose company (tokutei mokuteki gaisha; “TMK”) and a special purpose trust (tokutei mokuteki shintaku; “TMS”).

While there were a number of benefits in comparison to SPCs when the Securitisation Law was first introduced, following a series of amendments to the general corporations law, many of the benefits were lost as they no longer belong only to TMKs. The primary benefits that still remain are: the pass-through tax status; beneficial tax treatment in connection especially with real estate taxes; and withholding tax on securities. Characteristically, a TMK is allowed to acquire only certain types of assets listed under the statute and the rules promulgated thereunder. In addition, TMKs are required to obtain evaluation(s) of the assets that each will acquire prior to the actual acquisitions thereof and the evaluations are required to be made by certain individuals/entities satisfying the qualifications stipulated in the statute. TMKs are allowed to issue bonds (tokutei shusshi), physical CPs (tokutei yakasoku tegata) and book-entry CPs (tokutei tanki shusshi) and preferred equity securities (yusen shusshi) to finance their acquisition of assets to be securitised. While a TMK may borrow money to finance such acquisition, some tax benefits would be lost if not from lenders that are qualified institutional investors defined under the Financial Instruments and Exchange Act of Japan (which is the main body of securities-regulations of Japan). Since TMKs are designed to be SPCs in nature, the statute prohibits TMKs from certain matters such as hiring employees, having a branch office, not appointing an underwriter/dealer in respect of its securities, doing business other than its “securitisation business” and not delegating the management (including sale and other dispositions) of its assets to qualified third parties.

A TMS has almost never been used due to its inflexibility in connection with structuring and the absence of tax benefits in respect of withholding tax, etc.

7.2 Securitisation Entities. Does Japan have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes, see question 7.1.

(a) While there are not many special requirements in establishing a TMK other than to name it a TMK in accordance with the statute, in order for a TMK to engage in the “securitisation business”, among other requirements, the TMK must file a “business commencement statement” (gyoumu-kaishi-todokede) with a governmental agency prior to initiation of the TMK’s “securitisation business”; an “asset liquidation plan” (shisan-ryuudouka-keikaku), which identifies the assets to be securitised and the terms and conditions of asset-backed securities to be issued and/or asset-backed loans to be borrowed to finance the acquisition of such assets by the TMK, must be attached to the statement as part of the exhibits thereto.

As for the management of TMKs, the statute provides certain rules in terms of the corporate governance regime, such as the requirement that no director (torishimariyaku) or statutory auditor (kansayaku) of a TMK may be a director of the entity that sells assets to the TMK as well as the requirement that an accountant or an accountancy firm be appointed as the TMK’s statutory accounting auditor (kaikei kansanin) when certain conditions are met.

(b) See question 7.1 above.

(c) While there is no positive requirement/qualification for the status of a director or of a shareholder specifically stipulated under the statute, corporations in general and certain persons are barred from becoming a director (the list includes the seller or directors of the seller, bankrupt individuals receiving no rehabilitation order, individuals convicted of certain financial crimes, etc.).
7.3 Non-Recourse Clause. Will a court in Japan give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

The general belief is that non-recourse provisions will be upheld as valid at least prior to the insolvency of the obligor. The same applies with most types of contracts even if a given contract is governed by non-Japanese law, so long as the provision is valid under that governing law. To the contrary, validity and legal effects of non-recourse provisions upon the insolvency of the obligor are not clear under Japanese law.

7.4 Non-Petition Clause. Will a court in Japan give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The general belief is that non-petition provisions will be upheld as valid for so long as the scope of a provision is reasonable (such as the effective term of the provision being limited to one year and one day after the payment in full to the investors); however, a Japanese court may treat a petition made in violation of a non-petition as a valid petition and determine that the remedy for the violation is to be provided through monetary compensation rather than dismissing the petition.

Since the matter concerns proceedings under the Japanese legal system, the governing law of non-petition provisions should be Japanese law. Whether Japanese courts will uphold non-petition provisions governed by non-Japanese law is unclear.

7.5 Priority of Payments "Waterfall". Will a court in Japan give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, but excluding insolvency courts. If an insolvency proceeding is commenced in connection with the debtor, then the relevant insolvency statutes will come into effect, in which case, certain waterfall provision that contradicts with the priority rules provided under the insolvency statutes will not be honoured by the competent court.

7.6 Independent Director. Will a court in Japan give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The general belief is that such arrangements cannot be made under the Japanese legal environment, and therefore, in most cases, a Japanese SPC will have a sole independent director rather than having multiple directors that may include non-independent directors.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Japan, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Japan? Does the answer to the preceding question change if the purchaser does business with other sellers in Japan?

First, under Japanese law, there is no concept of a qualification to do business in Japan applicable to foreign corporations; however, foreign corporations are required to (1) appoint at least one representative officer/director who resides in Japan, and (2) register with a governmental agency, if they are to continuously do business in Japan; provided, further, that a foreign corporation whose primary purpose is to do business in Japan may not continuously do business in Japan, and a foreign corporation whose head office is located in Japan also may not continuously do business in Japan. Whether a one-time purchase and ownership or its collection and enforcement of receivables by a foreign SPC will be deemed a “continuous business” remains a subtle question the answer to which is unclear (but if the foreign SPC does business with other sellers, then there is a chance that it will be deemed as doing continuous business in Japan; however, the governmental authority has suggested that the regulation is not intended to be applied to foreign corporations used as vehicles in securitisation transactions). Separately, regardless of whether the purchaser is a foreign entity or a domestic entity, the purchaser may be prohibited from purchasing receivables depending on the asset class. That is, since the Lawyers Code provides that no person may engage in the business of purchasing or otherwise acquiring receivables to enforce the receivables by means of litigation, mediation, conciliation or other means, the purchase of receivables may be deemed a violation of the Code, for example, if all of the purchased receivables are destined to be enforced through litigation. However, the Supreme Court has opined that a purchase of receivables does not violate the Code if the purchase does not harm the obligors’ or public citizens’ rights and legal interests and if the purchase falls within socially and economically justified business.

In addition, if the receivables to be purchased are, or include, a loan or loans extended by a moneylender regulated under the Moneylenders Law, then certain provisions of the statute will become applicable to the purchaser (even if the purchaser is a foreign entity); see question 8.3.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

There is no general restriction on a seller of receivables continuing to collect receivables following their sale to the purchaser, however, collection activities of the seller are legally permissible only to the extent that they do not constitute or involve “legal affairs”, which include appearance before a court.

Save for limited exceptions available to judicial scriveners and the exception made available to licensed special servicers, only an attorney or a legal corporation (which is incorporated law firm) can represent a third party and appear before a court. Therefore, unless the seller is a special servicer licensed under the Servicer
Law (the Act on Special Measures concerning Business of Management and Collection of Claims), the seller will not be able to appear before a court in enforcing the receivables sold to the purchaser.

8.3 Data Protection. Does Japan have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes. The Law Concerning the Protection of Personal Information regulates the: (i) acquisition; (ii) management and use; and (iii) disclosure of personal information about individuals (kōjin-jyōho), by certain enterprises/individuals handling such personal information (kōjin-jyōho-toriatukai-gyōsha). The statute protects information in respect of individuals but not of corporations.

In addition, certain businesses such as financial institutions and banks are required to maintain and otherwise handle information and data about, or provided by, its clients (especially individuals, but not excluding corporations or other enterprises) with the due care of professionals and maintain adequate confidentiality.

8.4 Consumer Protection. If the obligors are consumers, will the obligor in accordance with the Moneylenders Law.

If the receivables are loans extended by moneylenders regulated under the Moneylenders Law, the purchaser thereof will be subject to certain provisions of the statute, including, without limitation, the provisions providing for the following requirements:

- the purchaser will be required to deliver to each obligor, without delay, a notice that clearly indicates certain details of the relevant loan as required under the statute and rules promulgated thereunder upon the purchase of such receivables; and
- the purchaser will be required to furnish a receipt to each obligor every time the purchaser receives a payment from the obligor in accordance with the Moneylenders Law.

8.5 Currency Restrictions. Does Japan have laws restricting the exchange of Japan’s currency for other currencies or the making of payments in Japan’s currency to persons outside the country?

(i) The Foreign Exchange and Foreign Trade Law, which is the statute primarily governing exchanges of currency does not restrict the exchange of Japanese currency for other currencies; however, that there are certain after-the-fact reporting requirements.

(ii) Under the same statute, the making of payments or other transfer of money to persons of certain countries such as countries the subject of economic sanctions is subject to approval by the government. Also, if a payment or other transfer of money to persons outside of the country is made by a resident of Japan, then such resident will be required to make an after-the-fact report to the relevant authority, except for cases prescribed in the relevant rules (such as a payment of less than a hundred million Yen).

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Japan? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

The issue depends on a number of factors, such as the nature of the receivables, whether they bear interest, whether the seller (or the purchaser) is a resident of Japan, whether there is a tax treaty between Japan and the country or jurisdiction of the seller (or the purchaser), and whether the payment by the obligor is made within Japan.

9.2 Seller Tax Accounting. Does Japan require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The Corporations Tax Law generally requires corporations to adopt the Japanese GAAP unless otherwise required by law. Since there is no statute that specifically provides for an accounting policy for the seller or the purchaser in the context of a securitisation transaction, the Japanese GAAP will generally control; although there are certain matters for which tax law requires modifications to the accounting principles. For securitisation of receivables, the Accounting Policy regarding Financial Products introduced by the Accounting Standards Board of Japan, as well as the Practical Policy regarding Financial Products Accounting and Q&A for the Financial Products Accounting published by a committee of the Japanese Institute of Certified Public Accountants provide the accounting rules.

9.3 Stamp Duty, etc. Does Japan Impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty (inshi-zei) of 200 Yen is imposed on a contract whereby a receivable is assigned (e.g., a receivables sale agreement) with a sale value equal to or greater than 10,000 Yen.

9.4 Value Added Taxes. Does Japan impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Consumption tax (shōhi-zei) and local consumption tax (chiho-shōhi-zei) are imposed on the sale of goods or services otherwise exempted by relevant laws or regulations. With respect to sales of receivables, no consumption tax is imposed, whereas consumption tax and local consumption tax will be imposed on fees for collection agent services.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

(i) Stamp duty

The purchaser is liable jointly and severally with the seller, if both the purchaser and the seller have prepared the documents together.
9.6 Doing Business. Assuming that the purchaser conducts no other business in Japan, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Japan?

As for stamp duty, see question 9.5 (stamp duty will be imposed irrespective of the status of the purchaser). With respect to income tax, if the purchaser is a foreign corporation or a non-resident of Japan, the income from the collection of the receivables will be taxable in Japan (and, if the purchaser has no “permanent establishment” in Japan, then withholding tax would generally be imposed with respect to certain income from receivables such as interest on loans). As for corporate tax, the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors will not generally make it liable to corporate tax in Japan as long as the purchaser conducts no other business in Japan and is treated as having no permanent establishment nor its agent/representative in Japan with certain authority to act on behalf of the purchaser.

Note that if there is a tax treaty between Japan and the jurisdiction of the foreign corporation, the rules described above might be amended thereby.

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Under Luxembourg law (provided the parties have reached an agreement) it is not necessary that the parties enter into a written agreement to evidence the sales of goods or services. According to article 109 of the Luxembourg Commercial Code any means of evidence (including invoices) are acceptable in respect of agreements between merchants (commerçants) and, depending on the specific circumstances, an agreement between parties may be evidenced by their behaviour. However, according to article 1341 of the Luxembourg Civil Code, a contract, unless entered into between merchants (commerçants), shall be evidenced in writing if the value of the contract exceeds the amount of EUR 2,500.

1.2 Consumer Protections. Do Luxembourg’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Consumer credit. The interest rate may, in principle, be freely determined between the parties to a loan agreement, which may exceed the legal interest. However, if the interest rate is manifestly usurious, a Luxembourg court may reduce the interest to the applicable legal interest rate. If the borrower is a consumer, information must be provided regarding the effective annual global interest rate (taux annuel effectif global) and on the interest amount charged for each instalment.

Interest on late payment. In commercial transactions between professionals the Luxembourg law dated 18 April 2004 relating to late payment and overdue amounts (as amended) sets a maximum limit calculated on the basis of the ECB’s key interest rate (taux directeur) plus seven per cent. In transactions between a professional and a consumer, a regulation sets the maximum interest rate that may be applied by such professional in the event of a delay in payment.

Compounding of interest. Contractual compounding of interest is, in principle, not permitted under Luxembourg law unless with respect to interest due and payable for a period of at least one year, and on which compounding the parties have agreed in writing.

Early repayment. A consumer has the right to early repayment of its debt without penalties. The lender may not charge any additional amount for the remaining term of the loan (i.e., interests or costs). However, the lender is entitled to recover fair and objectively justified costs which are directly linked to the early repayment provided that the early repayment has been made during a fixed-rate period.

Consumer’s right of withdrawal. Under article L. 224-15 of the Luxembourg Consumer Code, a consumer has a right of withdrawal in connection with its entry into a loan agreement with a professional without any justification and for a period of 14 calendar days calculated on the later of: (i) the day of entry into the loan agreement; or (ii) the receipt by the consumer of the terms and conditions of the loan agreement. Under article L. 221-3 of the Consumer Code, a similar right is granted to consumers in relation to a number of other agreements (i.e., distance financial services contracts).

Moratorium on consumer’s debts. In relation to personal debts, individuals may request assistance from the Commission of Mediation in Luxembourg. Such request triggers an automatic stay of proceedings which may have been commenced against the applicant. The stay period can last up to six months and may result, among others, in a restructuring of the debts or in a reduction of agreed interest rates.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

In general, there are no different requirements, which apply under Luxembourg law, if a receivables contract has been entered into with a public entity in Luxembourg provided the public entity is carrying out a commercial transaction and is acting jure gestionis, i.e., the transaction is governed by private law as opposed to sovereign acts jure imperii, which are governed by public law.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Luxembourg that will determine the governing law of the contract?

The provisions of Regulation (EC) n. 593/2008 on the law applicable to contractual obligations (the Rome I Regulation) are directly applicable in Luxembourg. If the seller and the obligor do not specify
an express choice of law governing the receivables contract, the applicable law will be the law of the country which is most closely connected to the situation and which is typically the law of the country where the party to effect the characteristic performance of the contract has its residence, unless when it results from the circumstances that the contract is manifestly more closely connected with another country, in which case the law of that country shall apply.

2.2 Base Case. If the seller and the obligor are both resident in Luxembourg, and the transactions giving rise to the receivables and the payment of the receivables take place in Luxembourg, and the seller and the obligor choose the law of Luxembourg to govern the receivables contract, is there any reason why a court in Luxembourg would not give effect to their choice of law?

Provided the seller and the obligor both have their seat in Luxembourg, the transfer of the receivables and their payment will occur in Luxembourg and the seller and the obligor have chosen the law of Luxembourg to govern the receivables contract, the choice of the parties to have the receivable contract governed by Luxembourg law will be recognised and upheld by a Luxembourg court in accordance with the provisions of the Rome I Regulation.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Luxembourg but the obligor is not, or if the obligor is resident in Luxembourg but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Luxembourg give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

If either: (i) the seller has its seat in Luxembourg but not the obligor; or (ii) the obligor has its seat in Luxembourg but not the seller and the parties choose the foreign law of the country, in which either the obligor or the seller have their respective seat, to govern the receivable contract, the choice of the parties to have the receivable contract governed by foreign law will be recognised and upheld by a Luxembourg court in accordance with the provisions of the Rome I Regulation provided the application of the provisions of foreign law would not be manifestly incompatible with Luxembourg public policy (ordre public).


3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Luxembourg’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Luxembourg’s laws or foreign laws)?

In principle, Luxembourg law does not require the sale of receivables to be governed by the same law as the law governing the receivables given that in accordance with the provisions of the Rome I Regulation, the parties are free to choose the governing law of the transfer agreement which will determine the relationship between the assignor and the assignee. Pursuant to article 14 of the Rome I Regulation the law governing the receivables will, among others, determine: (i) the assignability of the receivables; (ii) the relationship between the assignee and the debtor; (iii) the conditions under which the assignment can be invoked against the debtor; and (iv) whether payment by the debtor shall have the effect of discharging the debtor’s obligations.

3.2 Example 1: If (a) the seller and the obligor are located in Luxembourg, (b) the receivable is governed by the law of Luxembourg, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Luxembourg to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Luxembourg, will a court in Luxembourg recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

A court in Luxembourg will recognise the sale of receivables as being effective against the seller, the obligor and other third parties (such as the creditors of the seller) provided the sale of receivables is compliant with Luxembourg law. An insolvency receiver appointed with respect to the seller would, under Luxembourg law, typically not be considered as a third party but could, under certain circumstances, refuse to be bound by the sale of receivables.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Luxembourg, will a court in Luxembourg recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Assuming the provisions of the Rome I Regulation are applicable, the sale of receivables is effective against the seller, the purchaser and the obligor. However, it is not clear under the Rome I Regulation, which legal provisions determine the effectiveness of a transfer of receivables against third parties other than the obligor. Luxembourg conflict of law rules would generally point to the law of the country where the debtor is located and hence the formalities provided by the relevant foreign law for effectiveness against third parties would need to be analysed on a case-by-case basis.

If the receivables were assigned to a Luxembourg securitisation vehicle, the articles of incorporation of which are governed by the Securitisation Law (as defined below), the law of the country where the assignor has its seat governs the condition of effectiveness of the assignment against third parties.

An insolvency receiver appointed with respect to the seller would, under Luxembourg law, typically not be considered as a third party but could, under certain circumstances, refuse to be bound by the sale of receivables.
Under Luxembourg law, receivables may further be transferred by way of contractual subrogation, i.e. a third party will pay to the original creditor the amount owed by the debtor and will then be subrogated to all rights the original creditor could have exercised against the debtor prior to the payment by the third party.

Further, receivables may be transferred by way of novation, i.e. all parties must consent that a new creditor will substitute the original creditor and assume its obligations under a new agreement made between the new creditor and the debtor.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The perfection of the sale of receivables by way of assignment requires the notification of the debtor pursuant to article 1690 of the Luxembourg Civil Code. Prior to the notification and provided the debtor is not aware of the assignment, the debtor will be discharged while making payments to the seller.

If the purchaser is a securitisation vehicle, the articles of incorporation of which are governed by the Securitisation Law, and provided both the seller and the debtor have their seat in Luxembourg, the assignment of the receivables is perfected when the seller and purchaser have executed the transfer agreement. Hence, for perfection purposes a notification of the transfer to the debtor is not required. However, provided the debtor is not aware of the assignment, the debtor will be discharged while making payments to the seller.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Promissory notes and bills of exchange. Promissory notes (billets à ordre) and bills of exchange (lettre de change) are commercial papers (effets de commerce) the transfers of which are regulated by the Law of 15 December 1962 relating to promissory notes and bills of exchange. Pursuant to articles 11 et seq. of that law, promissory notes are transferred through endorsement (endossement) by means of physical delivery.

Consumer loans. Pursuant to article L. 224-18 of the Consumer Code, the assignment of a consumer loan to a third party must be notified to the contracting consumer. However, this information is not relevant if the original creditor continues to service the credit vis-à-vis the consumer. Consequently, if the assignment has not been notified to the consumer, all payments made by the consumer towards the original lender are valid, as the original creditor remains the sole financial counterparty of the consumer and not the purchaser.

Marketable debt securities. According to the provisions of the law of 10 August 1915 on commercial companies, as amended, the transfer of debt securities in bearer form is effected by the means of physical delivery from the transferor to the transferee, whereas the transfer of the debt securities in registered form must be recorded in the relevant register and be notified to the debtor in accordance with article 1690 of the Luxembourg Civil Code.

The transfer of registered debt securities held on an account within the system of a securities depositary will be carried out by matching instructions from the transferor and the transferee to the securities
4.4 Obligor Notifications or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

As set out above, the sale of receivables must be notified by the seller or the purchaser to the debtor in order to be perfected unless the purchaser is a securitisation vehicle and the seller and the debtor have their seat in Luxembourg. In any case, if the debtor is not aware of the assignment, the debtor will be discharged while making payments to the seller. The debtor’s consent to the assignment is not required provided the loan agreement does not contain a clause preventing the seller from transferring the receivables. If the seller, despite such a clause in the loan agreement, assigns the receivables to the purchaser, the purchaser is, from a Luxembourg law perspective, likely not to be bound by this clause except if the purchaser has accepted the terms of the loan agreement.

If the purchaser of the receivables is a securitisation vehicle and the loan agreement between the seller and the debtor prevents an assignment of the receivables, the assignment will not be enforceable against the assigned debtor, unless (i) the debtor has agreed thereto, or (ii) the assignee legitimately ignored such non-compliance, or (iii) the assignment relates to a monetary claim (créance de somme d’argent).

Provided the conditions for a set-off are satisfied, the debtor may set off its debt against obligations owed by the seller to the debtor even after a notification of the assignment.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no particular rules applying to the form of notice and the manner in which the notice is delivered to the debtor. The notice can extend to future receivables provided the future receivables are determined or determinable.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Luxembourg? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Luxembourg recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Please see the answer to question 4.4 above.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The transfer agreement does not need to specifically identify each of the receivables. However, the assigned receivables must be determined or determinable.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denote their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

In principle, a Luxembourg court will consider the economic characteristics of the sale and not per se rely on the denomination of the transaction given by the parties. Unless a Luxembourg court will, based on the factual elements of a transaction, take the view that it was the intention of the parties to transfer the receivables for security purposes rather than to achieve a true sale and despite the seller retaining the credit risk, the interest risk, the control of collections of receivables or a repurchase/redemption right in relation to the receivables, it is unlikely that a Luxembourg court would, provided the sale of receivables has been duly perfected, recharacterise the transaction as a secured loan, even though this has not yet been tested in court. Pursuant to the provisions of the Securitisation Law, a claim assigned to a securitisation vehicle becomes part of its property as from the date on which the assignment becomes effective notwithstanding any undertaking of the securitisation vehicle to
reassign the claim at a later date and that the assignment can be recharacterised on grounds relating to the existence of such undertaking. Furthermore, the securitisation vehicle may entrust the assignor or a third party with the collection of receivables or with any other task relating to their management.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The seller may agree to a continuous sale of receivables provided the receivables are determined or determinable and that the sale has been notified to the debtors.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

In principle, a sale of future receivables is possible under Luxembourg law provided the future receivables are determined or determinable and that the sale has been notified to the debtor(s).

The Securitisation Law expressly allows the assignment of future receivables and a securitisation vehicle can assert the assignment against third parties from the time of the agreement with the seller on the effective assignment of future receivables, which applies notwithstanding the opening of insolvency proceedings against the seller prior to the date on which the receivables come into existence.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The assignment of the receivables triggers, from a Luxembourg law perspective, the transfer of all rights and obligations incidental to the assigned receivables in favour of the purchaser. Thus, all accessory security interests (provided they are governed by Luxembourg law) securing the obligations under the assigned receivables in favour of the purchaser. The Securitisation Law expressly allows the assignment of future receivables and a securitisation vehicle can assert the assignment against third parties from the time of the agreement with the seller on the effective assignment of future receivables, which applies notwithstanding the opening of insolvency proceedings against the seller prior to the date on which the receivables come into existence.

5 Security Issues

5.1 Back-up Security. Is it customary in Luxembourg to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Given that, in general, it can be ascertained that the sale of receivables has been perfected, it is not customary in Luxembourg to take security over the seller’s ownership interest in the receivables. However, the taking of additional security is of course possible.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Luxembourg, and for such security interest to be perfected?

Please see the answers to questions 5.1 and 5.3.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Luxembourg to grant and perfect a security interest in purchased receivables governed by the laws of Luxembourg and the related security?

The Law of 5 August 2005 on financial collateral arrangements, as amended (Law on Financial Collateral) typically governs agreements creating security interests over receivables.

In practice, security interests over receivables are either created by a pledge agreement or by a transfer of title by way of security agreement each governed by the provisions of the Law on Financial Collateral. To perfect a pledge over receivables the purchaser acting as pledgor must be dispossessed with respect of the pledged assets, which can typically be achieved by notifying the debtor of or, as the case may be, having the debtor accept, the pledge over receivables.

With respect to a transfer of title by way of security the purchaser transfers the ownership in relation to the receivables to the secured parties until the secured obligations have been discharged triggering the obligation of the secured parties to retransfer the receivables to the purchaser. When executed by the purchaser and the secured parties, the transfer agreement has been perfected. However, the debtor of the receivables will be discharged while making payments to the purchaser unless the debtor has been notified of the transfer of the title of the receivables to the secured parties.

A securitisation vehicle may only create security interests over its assets for the purpose to secure the obligations it has assumed for their securitisation or in favour of its investors or the trustee or fiduciary-representative acting for the investors.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Luxembourg, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Luxembourg or must additional steps be taken in Luxembourg?

The creation, perfection and enforcement of a security interest over receivables, which are, or are deemed to be, located in Luxembourg, are, pursuant to applicable Luxembourg conflict of law rules, governed by Luxembourg law.

Hence, even if the security interest over Luxembourg receivables were to be validly created and perfected pursuant to the applicable law of the country, where the purchaser has its seat, said security interest would, from a Luxembourg conflict of laws perspective, only be validly created, perfected and enforceable, if the applicable Luxembourg rules are complied with.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security interests over claims arising under insurance policies, mortgage loans or consumer loans would either be granted in the
form of a pledge or a transfer of title by way of security and insofar, as regards their perfection, the answer in question 5.3 is applicable.

A security interest over a promissory note is perfected by way of endorsement indicating that the security has been transferred for security purposes.

A security interest over debt securities in bearer form is perfected by the physical delivery of the debt securities to the pledgee or, as the case may be, depositary acting for the pledgee. A security interest over debt securities in registered form is perfected by inscription of the pledge in the register held with the issuer of the debt securities. A security interest over debt securities in registered form held on an account within the system of a securities depositary is perfected by, among others, (i) the entry into the pledge agreement made between the pledgor, the pledgee and the securities depositary or between the pledgor and the pledgee with notification to the securities depositary provided the latter will follow the pledgee’s instructions relating to the debt securities, (ii) the registration of the debt securities on an account opened in the name of the pledgor, or (iii) the indication in the books of the securities depositary that the debt securities are pledged provided the debt securities are held on an account opened in the name of the pledgor.

A transfer of title by way of security in relation to registered debt securities is perfected by the transfer of the debt securities to an account opened in the name of the transferee or, if the debt securities are held on an account opened in the name of the transferor, the indication in the books of the account bank, that legal title to the debt securities has been transferred to the transferee.

5.6 Trusts. Does Luxembourg recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Pursuant to the law of 23 July 2003 on trusts and fiduciary agreements foreign trusts are recognised in Luxembourg to the extent that they are authorised by the law of the jurisdiction in which they are created.

Furthermore, according to the law of 23 July 2003 on trusts and fiduciary agreements a Luxembourg fiduciary may enter into a fiduciary agreement with a fiduciants, pursuant to which the fiduciary becomes the owner of a certain pool of assets forming the fiduciary estate, which are, even in an insolvency scenario, segregated from the assets of the fiduciary and are held off-balance.

5.7 Bank Accounts. Does Luxembourg recognise escrow accounts? Can security be taken over a bank account located in Luxembourg? If so, what is the typical method? Would courts in Luxembourg recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Luxembourg?

Luxembourg law recognises the mechanism of escrow accounts, though this mechanism does not constitute a security striceto senso and is not covered by the Law on Financial Collateral.

Security interests may be created over the balance standing to the credit of a specific bank account, which typically take the form of a pledge governed by the Law on Financial Collateral.

If, pursuant to Luxembourg conflict of laws rules, an account is located, or would be deemed to be located, in Luxembourg, the relevant Luxembourg provisions will apply regarding the creation, perfection and enforceability of a security interest over such account. Hence, if the foreign law would not provide for the same rules, a Luxembourg court will not recognise the foreign law security interest over a Luxembourg account and would apply the relevant Luxembourg rules as regards the creation, perfection and enforceability of a security interest over an account located in Luxembourg.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Upon the occurrence of an event of default, the secured party would enforce the account pledge. As a result, the account bank would block the pledged account and the pledgor would have no further access to the account. Hence, the pledgee controls, upon the occurrence of an event of default, the pledged account (unless the parties have agreed on a different mechanism in the pledge agreement regarding the access to the account after an event of default has occurred) until the secured obligations have been fully discharged. Following the discharge of the secured obligations, the pledgee has the obligation to de-block the account and to release the pledge.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Pursuant to the provisions of the Law on Financial Collateral, the pledger may grant to the pledgor a right of use with respect to the financial instruments and of the cash receivables pledged in favour of the pledger.

Typically, the parties agree on the obligation of the person, to whom the right of use has been granted, to transfer an equivalent collateral to replace the financial instruments and cash receivables at the latest on the date scheduled for the performance of the obligations under the pledge agreement or at any prior date upon the occurrence of margin calls, if the value of the pledged assets has decreased to a certain collateralisation percentage in respect of the amount of the secured obligations owed to the pledger.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Luxembourg insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Provided the sale of the receivables cannot be challenged by the insolvency receiver appointed with respect to the seller, i.e. (i) the sale of receivables has been perfected in connection with applicable law, (ii) the sale has not been executed during the pre-bankruptcy suspect period, which is a period of six months and ten days preceding the opening of insolvency proceedings against the seller, or (iii) the receivables were not transferred under value, there will
be no stay of action preventing the purchaser from collecting, transferring or otherwise exercising ownership rights with respect to the receivables.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

The insolvency receiver could prohibit the purchaser’s exercise of rights by way of summary proceedings while challenging the validity of the transfer or the perfection of the transfer of the receivables.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Luxembourg for (a) transactions between unrelated parties and (b) transactions between related parties?

As stated in the answer to question 6.1 above, the insolvency receiver could challenge the validity of the transfer of receivables, if the transfer were executed during the pre-bankruptcy suspect period, which is a period of six months and ten days preceding the opening of insolvency proceedings against the seller.

As regards the length of the pre-bankruptcy suspect period, there is no difference with respect to transactions carried out between related or unrelated parties. However, if the activities and assets of the seller and the purchaser are commingled and hence could be seen as one common estate, the insolvency receiver may, depending on the factual circumstances, extend insolvency proceedings to the purchaser, which were initially commenced against the seller.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

In principle, and subject to what is stated in the answer to question 6.3 above, the insolvency receiver could not, in the context of an insolvency scenario, consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Luxembourg, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Provided the provisions of the Securitisation Law are applicable, a securitisation vehicle can assert the assignment of future receivables against third parties from the time of the agreement with the seller on the effective assignment of future receivables, which applies notwithstanding the opening of insolvency proceedings against the seller prior to the date on which the receivables come into existence.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Luxembourg establishing a legal framework for securitisation transactions? If so, what are the basics?

The Securitisation Law dated 22 March 2004, as amended (the Securitisation Law) established a particular legal framework for securitisation transactions in Luxembourg.

In accordance with the Securitisation Law, a securitisation is a transaction by which a securitisation vehicle acquires or assumes, directly or through another vehicle, risks relating to claims, other assets, or obligations assumed by third parties and issues securities, whose value or yield depends on such risks.

Under the Securitisation Law, almost all classes of assets are capable of being securitised. The securitisation may be completed either (i) on a true sale basis, whereas the securitisation vehicle will acquire full legal title in relation to the underlying assets, or (ii) by the synthetic transfer of the risk pertaining to the underlying assets through the use of derivative instruments. To finance the transfer of risk the securitisation vehicle must issue negotiable securities, i.e. equity or debt instruments, which can be freely transferred by assignment or physical delivery and which are subscribed by the investors. With the issue proceeds derived from the securities’ issue, the securitisation vehicle will acquire the risks pertaining to the underlying assets.

7.2 Securitisation Entities. Does Luxembourg have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The Securitisation Law allows for two types of securitisation entities, which may be set up in the form of a company or a fund. A securitisation fund does not have legal personality, is managed by a management company and consists of one or more co-ownerships (copropriétés) or one or more fiduciary estates. The management regulations expressly specify whether the fund is subject to the provisions of the Luxembourg Civil Code on co-ownership or to the rules on trusts and fiduciary agreements. The fund is managed, whereas the articles of incorporation of the securitisation vehicle are expressly made subject to the provisions of the Securitisation Law.

A securitisation company can be set up as a public limited liability company (société anonyme), a corporate partnership limited by shares (société en commandite par actions), a private limited liability company (société à responsabilité limitée) or a co-operative company organised as a public limited company (société coopérative organisée comme une société anonyme).

Unless the securitisation transaction is carried out as private placement, a securitisation company will be incorporated as a public limited liability company given that a private limited liability company may not issue securities to the public.
Further, if a securitisation vehicle will issue securities to the public on a continuous basis, its activity must be authorised by the Luxembourg financial sector regulator (the “CSSF”) prior to the first issue of securities. However, the securitisation vehicle may be exempt from the requirement to be licensed by the CSSF provided it does not issue more than three series of securities per year to the public or the denomination of the securities is at least EUR 125,000. If a securitisation vehicle is a regulated entity, the CSSF must approve the directors of the vehicle and hence the directors will need to evidence a certain track record and experience within the field of securitisation.

7.3 Non-Recourse Clause. Will a court in Luxembourg give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Under the Securitisation Law contractual limited recourse clauses are recognised (even if the relevant agreement or the terms and conditions of the notes are not governed by Luxembourg law) and will be upheld by Luxembourg courts. In addition, the Securitisation Law provides for a statutory ring fencing mechanism, which can be established by the creation of compartments within the securitisation vehicle. The securitisation vehicle may allocate assets and liabilities to a specific compartment and the creditors and investors of that specific compartment have no recourse to assets, which are allocated to other compartments of the securitisation vehicle, i.e. each compartment forms a separate estate the assets of which are segregated from those allocated to other compartments of the securitisation vehicle. The constitutional documents of the securitisation vehicle and the transactions documents entered into in relation to a specific securitisation transaction should always contain the appropriate limited recourse wording.

7.4 Non-Petition Clause. Will a court in Luxembourg give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Under the Securitisation Law non-petition clauses are recognised (even if the relevant agreement or the terms and conditions of the notes are not governed by Luxembourg law) and will be upheld by Luxembourg courts. Hence, investors or creditors of the securitisation vehicle may waive their right to submit a petition for the commencement of insolvency proceeding against the securitisation vehicle.

The constitutional documents of the securitisation vehicle and the transactions documents entered into in relation to a specific securitisation transaction should always contain the appropriate non-petition wording.

7.5 Priority of Payments “Waterfall”. Will a court in Luxembourg give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Under the Securitisation Law subordination clauses are recognised (even if the relevant agreement or the terms and conditions of the notes are not governed by Luxembourg law) and will be upheld by Luxembourg courts. The constitutional documents of the securitisation vehicle and the transactions documents entered into in relation to a specific securitisation transaction should always contain the appropriate subordination wording.

7.6 Independent Director. Will a court in Luxembourg give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

The enforceability of contractual provisions prohibiting the directors from taking specified actions (including commencing insolvency proceedings) without the affirmative vote of an independent director could be problematic from a Luxembourg perspective given that, in certain circumstances, the directors may have the legal obligation to make a filing for insolvency. However, the relevant articles of incorporation could provide that certain actions can only be validly taken with the affirmative vote of the independent director. However, the relevance of such a clause may be less important in the Luxembourg context, since a Luxembourg securitisation vehicle should be insolvency remote.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Luxembourg, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Luxembourg? Does the answer to the preceding question change if the purchaser does business with other sellers in Luxembourg?

The purchaser having its seat outside Luxembourg will not be required to obtain a business licence in Luxembourg or an authorisation from the CSSF approving its activity in connection with the provisions of the Luxembourg law dated 5 April 1993 on the financial sector, as amended (the Financial Sector Law) only because the purchaser will purchase, or collect, receivables from one or more sellers having their seat in Luxembourg or enforce, as the case may be, the receivables in Luxembourg acquired from them.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

A debt collection activity carried out in Luxembourg requires, in principle, the prior authorisation of the CSSF pursuant to the relevant provisions of the Financial Sector Law. However, a securitisation vehicle may entrust the seller or a third party with the collection of receivables. In such a scenario, the seller or the third party acting as a servicer do not need to apply for a CSSF licence under the Financial Sector Law. In a true sale transaction, the purchaser or, as the case may be, its representative will appear in court with respect to any litigation in connection with the receivables given that the purchaser is the legal owner of the receivables.
8.3 Data Protection. Does Luxembourg have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Law of 2 August 2002 on the protection of persons with regard to the processing of personal data, as amended (the Data Protection Law) establishes standards for the collection and processing of personal data, which restrict, among others, the use and dissemination of data about, or provided by, obligors to third parties and to entities having their seat in non EU-Member States. The person, whose data will be processed has a right of information, a right to access the data and a right to oppose any processing or communication of that data. The Data Protection Law only covers the processing of personal data in relation to individuals.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Luxembourg? Briefly, what is required?

The Consumer Code provides rules that are binding on the purchaser of receivables arising under a consumer credit contract. In general, notification with respect to the transfer of the receivables to the obligor should be made by the seller (Article L. 224-18 (2) of the Consumer Code). However, a notification is not required if the seller continues to service the credit vis-à-vis the consumer. Further, pursuant to Article L. 224-18 (1) of the Consumer Code the consumer retains the right to raise all defences and exceptions against the purchaser, which the consumer could have raised against the seller prior to the perfection of the transfer of the receivables.

8.5 Currency Restrictions. Does Luxembourg have laws restricting the exchange of Luxembourg’s currency for other currencies or the making of payments in Luxembourg’s currency to persons outside the country?

Luxembourg does not have currency or exchange controls or central bank approval requirements restricting payments to entities located outside Luxembourg.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Luxembourg? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

As a matter of principle, there is no withholding tax in Luxembourg on payments of all items of income from capital other than dividends. In particular, Luxembourg does not apply any withholding tax on interest paid by one of its residents to a Luxembourg non-resident. The withholding tax exemption also covers dividend payments made by securitisation companies or funds on shares.

By way of exception, payments on receivables could be subject to the Luxembourg so-called “Relibi Law” and European Savings Directive (EUSD), which establish respectively a final 10 per cent and a 35 per cent withholding tax on interest or other similar income paid by a paying agent to a natural person resident respectively in Luxembourg and in another EU Member State. The individual may relieve himself or herself from the EUSD’s withholding tax if he or she agrees to an exchange of information between the Luxembourg tax authorities and the tax authorities of the relevant Member State.

9.2 Seller Tax Accounting. Does Luxembourg require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Luxembourg has no specific accounting policy for tax purposes in the context of securitisation insofar as the Luxembourg tax law usually follows the accounting rules applicable in Luxembourg as per the law of 10 August 1915 on commercial companies, as amended. The Luxembourg accounting rules will vary according to the legal form adopted by the seller or purchaser.

With regard to securitisation vehicles, the form may either be that of a securitisation company or that of a securitisation fund. In both cases, an independent auditor must audit the securitisation vehicle.

If the securitisation vehicle opts in or issues securities to the public on a continuous basis, both the securitisation vehicle and independent auditor must be authorised by the CSSF.

A securitisation company is subject to the accounting rules under the law of 19 December 2002, whereas a securitisation fund is subject to accounting and tax regulations applicable to investment funds provided for by the law of 17 December 2010. Thus, the securitisation company may choose between Luxembourg GAAP under the historical cost convention, Luxembourg GAAP under the fair value convention, or IFRS, while the securitisation fund may choose IFRS or Luxembourg GAAP under mark-to-market convention unless otherwise stated in the management regulations.

Crucially, the CSSF has confirmed that securitisation companies with multiple compartments should present their financial statements in such a form that the financial data for each compartment is clearly stated.

In addition, waterfall structures and valuation method used to identify impairments or losses related thereto should be presented in the notes to the financial statements.

Finally, a securitisation vehicle may book additional liability (at least tax-wise) to compensate “technical profit”, i.e., profit linked to cash flows received by the securitisation vehicle which will be distributed to the shareholders of the securitisation company or the unit holders of the securitisation fund in later financial years, in order to provide a true and fair view of the financial situation and to avoid unwarranted taxation.

9.3 Stamp Duty, etc. Does Luxembourg impose stamp duty or other documentary taxes on sales of receivables?

According to article 52 § 1 of the law of 22 March 2004, all agreements entered into in the context of a securitisation transaction as well as all other deeds relating to such transaction are exempt from registration formalities if they do not have the effect of transferring rights pertaining to Luxembourg real estate, aircraft or ships. However they may be presented for registration, in which case they will be subject to a fixed charge of EUR 12.

9.4 Value Added Taxes (“VAT”). Does Luxembourg impose VAT, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

A securitisation vehicle should be considered as a taxable person according to the Circular n. 723 issued by the Luxembourg VAT Administration (“Administration de l’enregistrement et des
domains”). Should the purchaser be considered as a taxable person in Luxembourg, the sale of goods or services would generally be subject to VAT at rates typically lower than those of Luxembourg’s neighbours (12 per cent and 15 per cent). However, transactions (except those related to collection of receivables) and negotiations related to receivables as well as management of securitisation vehicles located in Luxembourg are exempt from VAT.

The concept of “management” of securitisation vehicles is quite vague. In addition to the management of the portfolio (by the securitisation company itself, a management company or fiduciary representative), most administrative services (e.g., collection services) should benefit from the VAT exemption.

9.5 Purchaser Liability. If the seller is required to pay VAT, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

The purchaser is jointly and severally liable for the payment of VAT on goods and services sold to it (including relevant fines) toward the State where the VAT is due except if the purchaser proves that it has in good faith paid the VAT to the supplier.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Luxembourg, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Luxembourg?

Regarding tax that the purchaser would be responsible to withhold, the rules detailed above in question 9.1 are applicable. As the investors are treated like bondholders with no direct profit participation, no withholding tax should be applicable unless the payments of the purchaser fall under the scope of the “Relibi Law” or of the EUSD (it should nevertheless be kept in mind that the Luxembourg securitisation vehicles are entirely free to choose the kind of securities they issue and, therefore, may opt out of the Relibi Law and EUSD).

Regarding net wealth tax, securitisation vehicles are exempt. Regarding corporate income tax and municipal business tax, the tax treatment depends on the form of the purchaser.

A. Securitisation vehicle organised as a corporate entity

A securitisation vehicle organised as a corporate entity with either its statutory seat or central administration in Luxembourg is fully liable to corporate income and municipal business taxes at an aggregate tax rate of 29.22 per cent (irrespective of the vehicle’s activity and possible appointment of a servicer or collection agent).

However, in this case, commitments made by the purchaser to remunerate its investors qualify as interest on debt (even if paid as return on equity) and are fully tax deductible. Hence, the purchaser’s taxable basis should, as a rule, be very limited if not nil.

The purchaser should, nevertheless, be subject to a minimum flat tax. As of 1 January 2013, the purchaser should be identified as a Soparfi (i.e., a corporation that has aggregate financial assets, securities and bank deposits exceeding 90 per cent of its balance sheet total) and therefore be subject to a EUR 3,210 minimum flat tax (which includes a seven per cent solidarity surcharge).

Moreover, no capital duty applies on incorporation of the corporate form (except for a fixed registration duty of EUR 75).

Ultimately, securitisation companies may obtain tax residency certificates from the Luxembourg tax authorities to fully benefit from the European directives and Luxembourg’s important tax treaty network.

B. Securitisation funds

Securitisation funds should arguably be considered tax-wise as investment funds transparent for Luxembourg tax purposes. Hence, they are not liable to corporate income tax and municipal business tax.

Finally, both the fiduciary representative and the management company of a securitisation fund with their statutory seat or central administration (or even permanent establishment) in Luxembourg should be subject to corporate income tax, municipal business tax and net wealth tax in Luxembourg. They may also be subject to VAT (please refer to question 9.4 supra). The fiduciary representative must, in addition, pay a registration tax of EUR 1,000 and an annual registration tax of EUR 1,000 to the CSSF.
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Bonn & Schmitt is a leading Luxembourg law firm with an extensive international practice. The firm’s attorneys are experienced practitioners in the Luxembourg legal environment and represent a broad spectrum of expertise that allows them to deliver unrivalled legal solutions in one of Europe’s leading financial centres.
1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

It depends on the goods or services to be transferred. As provided in the Federal Civil Code (“Civil Code”) of the United Mexican States (“Mexico”), the general rule is that the transfer of real estate property or rights in rem on real estate property must be evidenced by a written agreement and formalised, in some cases, before a Notary Public. However, the transfer of property of mobile goods and rights in rem in connection with such kinds of goods, as well as the transfer of rights to services, is effective upon an agreement between the seller and buyer being reached, regardless of such agreement being evidenced in a document or not. However, in any case, it is convenient to evidence the sale of goods or services with a written agreement for the purposes of having an enforceable obligation of the obligor to the seller. Notice to the obligor is needed when receivables are assigned so that the obligor acknowledges that payments are to be made to the assignee instead of to the seller. In certain agreements it may be required to obtain the obligor’s agreement to effectuate the assignment of the receivables.

1.2 Consumer Protections. Do Mexico’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

No. There is no limitation on interest rates on consumer credits, loans or other kinds of receivables. The Mexican Central Bank (Banco de México) is the authority that may impose limits on interest rates. As of the time of writing this chapter, such authority has not imposed any limitations. Moreover, the Mexican Supreme Court (Suprema Corte de Justicia de la Nación) has ruled that it is legal for banks to charge interest on interest.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Yes. Government entities acting as sellers are subject to special laws and, thus, different requirements apply to agreements assigning receivables owned by the Mexican government or Mexican government agencies. The scope and the kind of different requirements to be fulfilled depend on the government and the government agency itself and their nature in accordance with Mexican administrative law.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Mexico that will determine the governing law of the contract?

Basically, the creation, regime and termination of rights in rem on real estate property, leasing of real estate property agreements and agreements regarding the limited time use of such kinds of goods, as well as mobile goods located in Mexico, will be governed by the laws of Mexico. Other commercial or mercantile agreements executed between parties will be governed by the laws contractually agreed by the parties, or in the absence of such agreement by the laws of the place in which the contract was executed.

2.2 Base Case. If the seller and the obligor are both resident in Mexico, and the transactions giving rise to the receivables and the payment of the receivables take place in Mexico, and the seller and the obligor choose the law of Mexico to govern the receivables contract, is there any reason why a court in Mexico would not give effect to their choice of law?

No, there is no reason.
2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Mexico but the obligor is not, or if the obligor is resident in Mexico but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Mexico give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Besides those cases in which the receivables represent collection rights to real estate property, in which case the law governing the assignment of such rights and the transactions thereon would be Mexican law, the seller and the obligors may choose another law different from Mexican law.


Yes, it is.

3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Mexico’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Mexico’s laws or foreign laws)?

Yes, provided that the receivables are not rights in rem as mentioned in questions 2.1 and 2.3 above. A Mexican court would give effect to their choice of law. However, it is important to consider that pursuant to the Mexican Commerce Code (Código de Comercio) in the absence of a fixed domicile of the parties in the sale agreement, the judge of the place where the contract was entered into shall be competent to act when the action is personal, and that of the location of the property when the action pertains to real estate property. In principle, we do not foresee any exceptions to this rule.

3.2 Example 1: If (a) the seller and the obligor are located in Mexico, (b) the receivable is governed by the law of Mexico, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Mexico to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Mexico, will a court in Mexico recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the seller)?

Yes, provided that the sale of the receivables to the purchaser is not limited or prohibited by law or by agreement between the seller and the obligor. Additionally, in respect to the creditors of the obligor and the seller in a scenario of an insolvency of either the obligor or the seller, transfers of the receivables from the obligor to the seller and from the seller to the purchaser should be valid and not questioned by a Mexican court if such transfers are not performed within the 270-calendar-day “claw back” period provided for in the Mexican Insolvency Act (Ley de Concursos Mercantiles).

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Mexico, will a court in Mexico recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Both foreign law requirements of the obligor’s and the purchaser’s countries will be taken into account. A Mexican court should recognise any foreign court resolution that transfers are valid pursuant to foreign laws and that transfers have been validly performed without affecting creditors in accordance with foreign insolvency laws, if all the requirements of article 1347-A of the Mexican Commerce Code (Código de Comercio) are duly fulfilled to have a foreign court resolution acknowledged, recognised and validated.

3.4 Example 3: If (a) the seller is located in Mexico but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Mexico recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Mexico’s own sale requirements?

Yes, parties may freely choose the law governing the receivables transfer or sale agreement. Assuming that the sale of receivables by the seller to the obligor is not limited or prohibited by law or by agreement between the seller and obligor and provided that the transfer is not performed within the mentioned 270-day “claw back” period provided for under the Mexican Insolvency Act (Ley de Concursos Mercantiles) in the case of a possible insolvency (concurso) of the seller, the sale should be valid and recognised by a Mexican court.

3.5 Example 4: If (a) the obligor is located in Mexico but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Mexico recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Mexico own sale requirements?

Yes the Mexican courts should recognise such transfer for the same reasons and subject to the same limitations set forth in question 3.4 above.
3.6 Example 5: If (a) the seller is located in Mexico (irrespective of the obligor's location), (b) the receivable is governed by the law of Mexico, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables transfer agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Mexico recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Mexico and any third party creditor or insolvency administrator of any such obligor)?

Yes, the Mexican courts should recognise such transfer for the same reasons and subject to the limitations expressed in question 3.4 above.

4 Asset Sales

4.1 Sale Methods Generally. In Mexico what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The seller usually enters into an Assignment Agreement with the purchaser (the “Assignment Agreement”). By the Assignment Agreement, the assignor (the seller) irrevocably assigns and transfers the property of the receivables and the accounts receivable to the assignee (the purchaser). The transfer of the receivables is not considered a loan having the receivables as collateral.

Usually, the purchaser is a trustee (the “Trustee”). The Trustee shall receive the assigned and transferred receivables and the accounts receivable. Such receivables and accounts receivable will be part of the corpus of a trust specifically created, as a special purpose vehicle (“SPV”), to manage such receivables and accounts receivables, as well as other assets forming the wealth of the SPV. Additionally, one of the main purposes of the Trust is to issue the securities that will later be publicly traded on the Stock Exchange.

Since the transfer of receivables and accounts receivable under the Assignment Agreement to the Trustee is effective and definitive, in principle such assets should no longer be subject to risks of further foreclosure in case of the insolvency proceeding of the seller. It is customary to use any of such terminologies but it is more usual to use the terminology “Assignment Agreement” (Contrato de Cesión de Derechos).

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The assignment and transfer of receivables and accounts receivable is valid upon agreement between the seller and the Trustee. However, it is necessary to evidence such assignment and transfer by the Assignment Agreement. In some cases, such assignment and transfer must be evidenced in a Mexican public deed depending on the nature of the right itself to be assigned (i.e. rights in rem to real estate property).

No consent on the side of the obligor is required by the seller to assign and transfer the receivables and accounts receivable to the Trustee, unless (i) such assignment and transfer is prohibited either by law or by previous agreement between the seller and obligor, or (ii) by the nature of the right to be assigned, making such assignment impossible. Therefore, provided that there is no limitation as to the assignment and transfer of the receivables and accounts receivable to the Trustee, only a written notice of the assignment and transfer to the SPV addressed to the obligor is required (the “Notice”). The Notice must be given either by an officer of a court or out-of-court by a document witnessed by two witnesses or even formalised before a Mexican notary public.

The Notice is required, so any payment to be made under the receivables and the accounts receivables is directed to the assignee only and not to the assignor (the seller) as from the date of the Assignment Agreement.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In the case of promissory notes, such negotiable instruments must be endorsed by the seller in favour of the Trustee, as assignee, as provided in the Mexican General Law on Negotiable Instruments and Credit Transactions (Ley General de Títulos y Operaciones de Crédito). No other formalities are generally required, but those mentioned in question 4.2 above.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors' consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Yes. Despite the legal validity and effectiveness of the assignment and transfer of the receivables and accounts receivable upon the execution of the Assignment Agreement, the Trustee shall be entitled to require payment to the obligor only if the Notice is given. Otherwise, the obligor may discharge its payment obligation by paying to the assignor, as original creditor. The Notice itself has no impact on the obligor’s set off rights and other obligor defences. Said rights and defences have their origin in law and in the obligor’s and seller’s agreement. For that reason, even the Notice itself has no impact in connection with those rights and defences, it would be convenient to have the transfer notified to the obligor to prevent any intention of the obligor to claim such rights and defences since they have been transferred to the purchaser. It would be important to determine whether or not such receivables transferred to the purchaser are subject to limitations derived from certain other obligors’ rights or not.
4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Notice is normally given in writing and it would be convenient to formalise it before a Mexican notary public or any other public attester, such as a Mexican corredor público. Usually the notice of transfer is simultaneously informed to the obligor or within the next days following the transfer from seller to purchaser. Notice may be used for current and future receivables. Limitations or prohibitions to the transfer of the receivables may arise only if the transfer is limited by law or by agreement between obligor and seller. Nevertheless, where the notice is given after insolvency (concurso) proceeding against the obligor or the seller, the Mexican insolvency judge will examine that transfer of accounts receivables has not been fraudulent conveyed during the “clawback” period (270 calendar days after the insolvency (concurso) is declared by the mentioned judge).

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Mexico? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Mexico recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

The general rule is that no consent is required from the obligor to assign and transfer the receivables and the accounts receivable or any other right as well. However, restrictions to the free assignment and transfer of rights may be imposed either by law or by contract or even by the nature of the right itself to be assigned to the SPV.

Yes. The seller in such a case would be liable for damages caused to the obligor as a consequence of the actual assignment of receivables, provided that such assignment and transfer was expressly forbidden.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

It is strongly advisable that the Assignment Agreement contains a description of the receivables and the accounts receivable assigned thereunder. The list of such receivables is attached to the Assignment Agreement, so further lists may be part of said agreement as so required from time to time. However, if the rights to be assigned and transferred under the Assignment Agreement may be generally identified, there is no need to specifically describe in detail each receivable assigned and transferred to the SPV. A general description on the characteristics of the rights to be assigned and transferred would be sufficient. The rationale is that the receivables and the accounts receivable to be assigned and transferred are, or may be, determined pursuant to the Assignment Agreement. If the Seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, it would be sufficient to state that all receivables are transferred except for those specifically described in the transfer agreement.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The assignment and transfer of the receivables to the SPV is perfected between the parties upon the execution of the Assignment Agreement. Usually, the SPV and the legal structure created using the Trust have the purpose of isolating the wealth used to fulfil payment obligations preventing the seller to retain credit and interest rate risks; in other words the assignment and transfer of assets to the SPV is a True Sale. Actually, the seller retains the control of collections and acts as servicer on behalf of the Trustee. A servicing agreement is executed between the seller and the Trustee for such purpose. However, in case of any wrong performance of the seller under the servicing agreement, a substitute servicer, obviously different from the seller, would collect payments for the Trustee for the final benefit of the holders of debt securities. The Seller may validly agree with the Purchaser to have a redemption right under certain conditions and that in principle should not jeopardise the perfection of the transfer. In other words, the Seller may be entitled to purchase asset backed securities as another investor.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes. Unless, other (i) agreements (containing specific negative covenants) to which the seller is party, (ii) court orders, or (iii) specific laws preclude the seller to do so.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Yes, it can. The sale of future receivables shall be structured in the same manner as current receivables are sold to be valid and enforceable.
In principle, Mexican Law will recognise security interests granted forming the wealth of the Trust.

**5 Security Issues**

### 5.1 Back-up Security. Is it customary in Mexico to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No. It is not customary to take a back up security over the seller’s ownership interest. Notwithstanding the foregoing, it is customary to get additional receivables from the seller. Mexican courts will analyse whether the assignment of the assets is legal or not. Therefore transferring additional receivables protects the security holder’s rights.

### 5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Mexico, and for such security interest to be perfected?

As explained above, the formalities depend on the nature of the rights that are being transferred. In certain cases, it is necessary to transfer the right before a Notary Public in the form of a public deed.

### 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Mexico to grant and perfect a security interest in purchased receivables governed by the laws of Mexico and the related security?

Usually for structuring this kind of transaction, a Mexican Trust is formed as an SPV. The seller will assign its receivables to the Trust, and certain additional receivables in excess, which will constitute collateral. Provisions obligating the seller to contribute an additional cash amount as additional collateral would be included in the trust agreement. In addition to such collateral, the Trust may be allowed to apply for a line of credit and grant as collateral the assets forming the wealth of the Trust.

### 5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Mexico, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Mexico or must additional steps be taken in Mexico?

In principle, Mexican Law will recognise security interests granted under the law of any third country. Notwithstanding, the granting of such security interests would have to comply with all Mexican law requirements in order for such security interests to be enforceable in Mexico. In the case of rights in rem, Mexican law is mandatorily applicable.

### 5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Each security document has its own formalities. Pursuant to Mexican law, a promissory note has to contain: (i) the fact that it is a promissory note; (ii) the unconditional promise to pay a certain amount of money; (iii) the name of the person to whom the payment has to be made; (iv) the date and place of payment; (v) the date and place in which the promissory note is being executed; and (vi) the signature of the obligor or obligors.

If the price of the asset that is being mortgaged exceeds 375 times the daily minimum wage (approximately US$1,700), the mortgage has to be granted before a Mexican notary public and, in the event of default, the asset would need to be transferred before a notary public.

### 5.6 Trusts. Does Mexico recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Mexico does recognise Trusts. Trusts are used as a mechanism whereby collections received by the seller in respect of sold receivables can be held or deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser.

### 5.7 Bank Accounts. Does Mexico recognise escrow accounts? Can security be taken over a bank account located in Mexico? If so, what is the typical method? Would courts in Mexico recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Mexico?

Normally, in Mexico, rights to the bank account funds may be pledged in favour of a creditor or an instruction is irrevocably given by an obligor to a Trustee or a bank to release funds from a bank account in favour of a creditor in case of default. Such instruction and the terms and conditions whereby the funds may be transferred to the creditor are usually documented through a mandate agreement.

### 5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

In principle yes, security over banking accounts is possible. A pledge of cash is considered by law as a transfer of the property of the cash to the pledgee, unless otherwise agreed by the parties. Consequently, the pledgee may have control of the cash deposited in the Bank Accounts since the moment in which the pledge agreement is signed if property of the cash is transferred or if not the case. The pledgee shall then have the obligation to transfer the cash to the pledgor when the payment obligations are repaid in full.
Parties may validly agree that the pledged cash will be the source of payment of any amounts owed after the pledge agreement is executed and therefore the pledger will have full control of the cash collateral. Where the cash is not transferred as a consequence of an agreement of the pledger and pledgee to repay the amounts owed, the principal limitation is that the pledger may not simply be paid by executing the pledged cash without a previous resolution of a Mexican judge.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

Yes, the owner may have access if the pledge is documented as a floating lien pledge. The pledgor shall have the obligation to reintegrate the cash so the collateral is in existence in full for the benefit of the secured parties. If the pledge is documented under articles 336 and 337 of the General Law of Negotiable Instruments and Credit Transactions (Ley General de Títulos y Operaciones de Crédito), the pledgor shall have no access to the pledged cash.

**6 Insolvency Laws**

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Mexico’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

Yes. Under the Mexican Insolvency Law (Ley de Concurso Mercantiles) (“MIL”) the insolvency official has the ability to stay collection and enforcement actions until he/she determines that the sale is perfected.

**6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the Insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?**

Under the MIL, there is a single insolvency proceeding known as “Concurso Mercantil” (“Concurso Procedure”). The Concurso Procedure consists of two main stages: the conciliation stage; and the bankruptcy stage, each of them supervised by the Federal Institute of Specialists in Insolvency & Bankruptcy Procedures (Instituto Federal de Especialistas de Concursos Mercantiles (IFECOM)). The Concurso Law forms part of the Federal commercial legislation of Mexico. Pursuant to article 17 of the Concurso Law, jurisdiction over a commercial bankruptcy case lies in the Federal District Court of the obligor’s corporate domicile, or its principal place of business, as the case may be (“Court”). The Concurso Law further provides that all claims against an obligor must be brought before the court hearing the case, in order to avoid different courts hearing claims against the estate in a “piecemeal” fashion.

The MIL is based upon certain general principles, as follows: (i) all creditors of the same class shall be treated the same, without regard to nationality, domicile or capacity; (ii) all creditors of the obligor, whether domestic or foreign, shall have access to the Concurso Procedure, and shall collect in equal proportion (according to the class) from the assets located within the territorial jurisdiction of the Court; (iii) the obligor’s operations should be preserved where possible for the benefit of the general economy of Mexico. This principle seeks to avoid the phenomenon of “chain bankruptcies”, where the commercial bankruptcy of one company and its cessation of operations causes the commercial bankruptcy of its creditors; and (iv) all assets of the obligor shall be consolidated and liabilities determined. This principle is the basis for actions taken to eliminate dubious credits, such as the commencement of legal proceedings to collect debts due in favour of the obligor, or actions to invalidate fraudulent conveyances or other transfers contrary to the MIL taken by the obligor in violation of the principle that all creditors of the same class should be treated the same. Also, in furthering the goals of this principle, third parties are permitted to recover assets in the obligor’s possession that are not owned by the obligor.

Following the declaration of insolvency, the Court (by its own decision or acting upon the Examiner’s (visitador) recommendation) may issue restriction orders on obligor’s conduct of business, including the prohibition of making payment under current and previous obligations or disposing of any property. During the Conciliation stage, the obligor may continue its ordinary course of business with a Conciliator reviewing the obligor’s operations and accounting. In principle, the obligor keeps management of its business, unless the Conciliator requests from the court the removal of the obligor in order to protect the pool of assets. If the obligor keeps the management, the Conciliator shall: (i) supervise the accounting and all transactions performed by the obligor; (ii) decide if any existing agreements binding on the obligor must be terminated; (iii) approve, with the prior opinion of the interveners appointed by the creditors, new credits in favour of the obligor, the creation of new security interests, the substitution of any existing security interests or the sale of any assets not involved in the ordinary course of business of the obligor; and (iv) call the board or any other decision-making committee of the obligor to discuss and approve any kind of matters relating to the obligor’s business. In the event the obligor is removed from the management of its business, the Conciliator will become the administrator and will be granted full authority to conduct the business, on the understanding that the authorities of the obligor and its decision-making committees shall cease. The Conciliator may also request from the court to suspend the obligor’s operations if the pool of assets or an increase in the obligor’s liabilities is at risk. The court may adopt measures to safeguard assets of the obligor for the benefit of the creditors, and assure that no actions are taken outside the ordinary course of business.
Securitisation Transactions

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Mexico establishing a legal framework for securitisation transactions? If so, what are the basics?

No. There is no specific law governing securitisation transactions. In fact, several laws are applicable for securitisation structured financings. The Civil Code (Código Civil), the Code of Commerce (Código de Comercio), the Stock Exchange Act (Ley del Mercado de Valores), the Credit Institutions Act (Ley de Instituciones de Crédito), and the Income Tax Law (Ley del Impuesto sobre la Renta), are applicable, among others. Additionally, rules issued by the Mexican National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) ("CNBV") are mandatory with respect to certain aspects of the securitisation process.

7.2 Securitisation Entities. Does Mexico have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There is no provision forcing an entity to establish an SPV for securitisation transactions. However, as mentioned above, it is common that Trusts are used as SPVs for such a purpose. Besides the creditworthiness of the issuer, the legal structure using an SPV improves the rating of the debt securities intended to be traded, particularly, since the assets, including the receivables and the accounts receivable are isolated and totally separated from the wealth of the seller, preventing (i) the seller to use the proceeds from the receivables and the accounts receivable for other purposes different from fulfilling payment obligations to holders of the issued debt securities, and (ii) in principle, any foreclosure on the transferred assets for the benefit of the mentioned holders in case of insolvency of the seller. Mainly, what is referred to in items (i) and (ii) above are the legal benefits of the SPV. There are no specific requirements as to the status of directors or shareholders since the SPV is not a corporation or a company but a Trust created to perform securitisation transactions.

7.3 Non-Recourse Clause. Will a court in Mexico give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Yes. Usually the financing structure created for securitisations transactions has the purpose of isolating the seller from the receivables and the proceeds therefrom. Therefore, this kind of financing is without recourse against the seller. Mexican courts will give effect to a contractual provision limiting the recourse of the parties to available funds.

7.4 Non-Petition Clause. Will a court in Mexico give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Yes it will. However, under the MIL, any contractual provision that creates a burden on the obligations of the debtor as a consequence of the filing of an insolvency procedure (i.e. an increase in interest rate) will be disregarded by the Court.

7.5 Priority of Payments “Waterfall”. Will a court in Mexico give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes, unless it is against provisions of “public order” and/or, as pointed out in question 7.4, under the MIL, any contractual...
provision that creates a burden on the obligations of the debtor as a consequence of the filing of an insolvency procedure (i.e. an increase in interest rate) will be disregarded by the Court. If the debtor is a Mexican merchant then the waterfall shall be that one agreed by the creditors in accordance with the MIL.

7.6 Independent Director. Will a court in Mexico give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

In principle yes, unless it is against provisions of “public order” and/or, as pointed out in question 7.4, under the MIL, any contractual provision that creates a burden on the obligations of the debtor as a consequence of the filing of an insolvency procedure (i.e. an increase in interest rate) will be disregarded by the court. If the debtor is a Mexican merchant then the waterfall shall be that agreed by the creditors in accordance with the MIL.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Mexico, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Mexico? Does the answer to the preceding question change if the purchaser does business with other sellers in Mexico?

Since the Trust is the SPV commonly formed for securitisation transactions, the Trustee must act as purchaser. Trustees are usually banks who have authorisation to act as such by the Mexican Ministry of Treasury and Public Credit (Secretaría de Hacienda y Crédito Público). Corporations may issue debt securities as a consequence of securitisation processes without the need to have an authorisation from said Ministry. However, to publicly trade the mentioned securities, in either cases, if issued by a Trustee or directly by a company or corporation, authorisation in that regard is mandatory and is granted by the CNBV and the Mexican Stock Exchange (Bolsa Mexicana de Valores, S.A.B. de C.V.).

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Usually, the only requirement is that the seller and the purchaser enter into a servicing agreement for the collection of the sold receivables.

8.3 Data Protection. Does Mexico have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

All the information on the obligor of the receivables, its creditworthiness and history is part of the information contained in the debt securities offering memorandum or prospectus. There is some information kept by the Trustee that is protected by the Trust secrecy provisions under the Credit Institutions Act. However, almost all the information required from the obligor to offer the debt securities is disclosed in the mentioned memorandum or prospectus. This is a natural request since the level of demand of the issued debt securities depends importantly on the payment capacity of the obligors.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Mexico? Briefly, what is required?

The Trustee has to maintain the confidentiality of the name of each obligor, pursuant to the Credit Institutions Act. There is a banking secret provision forbidding banks to disclose certain specific information.

8.5 Currency Restrictions. Does Mexico have laws restricting the exchange of Mexico currency for other currencies or the making of payments in Mexico currency to persons outside the country?

No. However, please be informed that any obligation in foreign currency to be paid in Mexican territory may be discharged by the obligor by paying Pesos at the applicable exchange rate on the date of payment published by the Mexican Central Bank, pursuant to the Mexican Currency Act (Ley Monetaria).

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Mexico? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Withholding tax is not triggered by payments of the obligor under the receivables to the SPV. Instead, withholding tax is triggered when payment is made to the debt security holder as final beneficiary. Withholding tax will be paid on interest paid or due and payable and the rates depend on provisions of treaties to avoid double taxation to which Mexico is party. Rates for withholding tax may be as low as 4.9 per cent in certain cases.

9.2 Seller Tax Accounting. Does Mexico require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No. The only policy is to follow Mexican GAAP or Normas de Información Financiera (NIFs) and to prepare the accounting information to be quarterly and annually disclosed to the stock exchange market following those principles.

9.3 Stamp Duty, etc. Does Mexico impose stamp duty or other documentary taxes on sales of receivables?

No, it does not.
9.4 Value Added Taxes. Does Mexico impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Yes, value added tax (“VAT”) on the sales of goods and services applies. In principle, the rate is 16 per cent provided that the VAT can be lower in certain zones of the country.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

No. The seller will charge 16 per cent of the amount of the sales transaction as VAT, and it is responsible to pay such retained amount to the Mexican tax authorities following certain tax rules. Hence, the purchaser only has the obligation to pay such amount to the seller for subsequent delivery to the tax authorities, as applicable.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Mexico, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Mexico?

In this case, the purchaser pays VAT in the acquisition of the receivables. Withholding tax on interests will be paid by final beneficiary depending on his/her/its nationality and the fact that Mexico has a treaty to avoid double taxation with the country of origin of the holder of the debt securities.
Chapter 27

Morocco

Benzakour Law Firm

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

In order to create an enforceable debt obligation of the obligor to the seller, it is necessary that the sales of goods or services are evidenced by a written receivable contract.

According to court practice, invoices alone would not be sufficient. They should be sustained/confirmed by a formal contract and/or acknowledgement of debt, purchase order(s) and bills of delivery.

In commercial matters, a written document is necessary to be contractually enforceable.

However in certain cases and circumstances, a contract may be implied between parties based on a course of conduct or dealings where the obligations arising from the alleged implied contract are sufficiently certain to be contractually enforceable.

1.2 Consumer Protections. Do Morocco’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

A loan granted to a consumer shall not carry an interest rate higher than a specified interest rate (taux d’usure).

As regards interest on late payments, the Moroccan Civil Code provides a statutory right to interest on late payment at a minimum interest rate fixed by Governmental Decree on an annual basis.

Under certain circumstances and conditions, the consumer may obtain the right to cancel a debt.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Moroccan law authorises the sale of receivables to a debtor which is a public body, including the Government or a Government Agency.

It is worth noting that the provisions relating to the sale of receivables shall be combined with the specific rules applicable to such public entities.

The sale of receivables must be notified to the public accountant (comptable public) of the public entity to which the receivable contract refers, and must be accompanied with the single original (exemplaire unique) of the receivable contract, where such a contract is a public procurement.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Morocco that will determine the governing law of the contract?

When the parties do not specify a choice of law, the receivables contract shall be governed by Moroccan law, if the seller and the obligor are located in Morocco or if the defendant is located in Morocco, in case of dispute and a claim filed before court.

There is also a principle for the law of the country with which it is “most closely” connected. It is presumed that the receivables contract is “most closely connected” with the country where the party effecting the performance is concluded.

2.2 Base Case. If the seller and the obligor are both resident in Morocco, and the transactions giving rise to the receivables and the payment of the receivables take place in Morocco, and the seller and the obligor choose the law of Morocco to govern the receivables contract, is there any reason why a court in Morocco would not give effect to their choice of law?

No, there should be no reason.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Morocco but the obligor is not, or if the obligor is resident in Morocco but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Morocco give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The parties are free to choose the law of their contract provided that...
the choice does not conflict with mandatory rules or public policy. However, questions of enforcement against the obligor of the receivables should be governed by the law of the jurisdiction in which the obligor is located.


3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Morocco’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Morocco’s laws or foreign laws)?

Moroccan law does not expressly require the sale of receivables to be governed by the same law governing the receivables themselves. The law applicable to the sale of receivables can be freely chosen by the seller and the purchaser of the receivables.

3.2 Example 1: If (a) the seller and the obligor are located in Morocco, (b) the receivable is governed by the law of Morocco, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Morocco to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Morocco, will a court in Morocco recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, it should.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Morocco, will a court in Morocco recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Yes, it would.

3.4 Example 3: If (a) the seller is located in Morocco but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Morocco recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Morocco’s own sale requirements?

Yes, it should unless the chosen law conflicts with certain mandatory rules in Morocco.

3.5 Example 4: If (a) the obligor is located in Morocco but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Morocco recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Moroccan’s own sale requirements?

It should, as above. However, enforcement against the obligor of the receivables would be subject to the exequatur procedure and governed by the law of the jurisdiction in which the obligor is located and his assets.

3.6 Example 5: If (a) the seller is located in Morocco (irrespective of the obligor’s location), (b) the receivable is governed by the law of Morocco, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Morocco recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Morocco and any third party creditor or insolvency administrator of any such obligor)?

Yes, it should.

4 Asset Sales

4.1 Sale Methods Generally. In Morocco what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

Certain conditions must be complied with in respect of a sale of receivables:
(a) the receivables must exist now or in the future;
(b) the receivables must belong to the seller;
(c) the receivables must be identified and individualised or be capable of being identified and individualised; and
d) the receivables must not be disputed, unless the obligor gave his consent.

The sale of the receivables must take the form of:
(i) An assignment under the common regime of the Moroccan Civil Code. The sale is valid between the seller and the purchaser but enforceable against third parties, subject to either the debtor being notified of the sale or the acceptance of the sale by the debtor in a deed executed before a public notary (acte authentique).

(ii) An assignment by way of subrogation. Under this method, a third party (the subrogee) pays the initial creditor (the subrogeant) and takes over the initial creditor’s rights against the debtor. The subrogation must be express and must occur at the time of the payment. As from the date of the subrogation, which shall coincide with the delivery of a formal receipt by the initial creditor to the third party (quittance subrogative), the transfer of the initial creditor’s rights against the debtor to the third party shall be effective.
(iii) An assignment under the Moroccan Securitisation Law. The assignment of the receivables is performed by way of a single transfer document (bordereau) exchanged between the seller and the purchaser. The assignment is effective between the parties and enforceable against third parties as from the date affixed on such transfer document without any further formalities.

Under this method, the sale of future receivables is allowed. Receivables that can be sold are receivables including mortgage guarantees, receivables of banks, of insurance companies, of public companies, of public affiliate companies and of companies receiving licences to render public services.

The purchaser must be a Fonds de Placement Collectif en Titrisation (FPCT), which is a co-ownership entity without legal personality jointly created by a management company and a custodian.

Among the advantages in using this method, related security interests in connection with the purchased receivables are automatically transferred to the FPCT without any further formalities.

The terminology varies; transfer, sale or assignment are all frequently used.

From a legal perspective, these are equal.

### 4.2 Perfection Generally

What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

In order for a sale of receivables to be perfected against third parties, the formalities required under the various methods of assignment described in question 4.1 must be complied with.

### 4.3 Perfection for Promissory Notes, etc.

What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Promissory notes are transferred by way of endorsement. The endorsement transfers the underlying debt to the new holder of such promissory notes.

 Marketable debt securities are transferred by way of a transfer order.

Mortgage loans and consumer loans are transferred in accordance to question 4.1 without the debtor’s consent depending on the method of assignment.

If the sale of the instruments referred to above is performed under the provisions of the Moroccan Securitisation Law to a FPCT, there are no formalities required in order to transfer the mortgage or other security interests securing the loans.

### 4.4 Obligor Notification or Consent

Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice—such as cutting off obligor set-off rights and other obligor defences?

Whether or not the notification and/or the consent of the debtors is required for a sale to be enforceable against the debtors will depend on the method of the assignment.

Under the common regime of the Moroccan Civil Code, a sale will be enforceable against the debtor upon a notification being served on him by registered letter or through a bailiff.

Under the Securitisation Law, the sale will be enforceable against the debtor as from the date of the sale without any requirement to notify him.

In all situations, notification of the assignment to the debtor freezes the right of set-off, of the debtor against the purchaser.

In the absence of any provision of the receivables contract expressly prohibiting assignment, the receivables may be freely assigned even without the consent of the debtor, except in respect of receivables for which Moroccan law prohibits the assignment.

The parties may still contractually limit the assignability of the receivables arising from the receivables contract.

### 4.5 Notification Mechanics

If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective—for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Notice must be in writing and detailed enough to make it clear which receivables have been sold.

A notice could be addressed after reorganisation proceedings against the obligor or the seller have commenced (with for the latest, the consent of the receiver).

### 4.6 Restrictions on Assignment; Liability to Obligor

Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Morocco? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Morocco recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on assignment or transfers of receivables should be enforceable.
4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

An assignment for value of an identifiable receivable, which is not in existence at the time of the receivables purchase agreement but which will be ascertainable in the future, is treated as an agreement to assign which will give rise to an assignment of the receivable as soon as it comes into existence.

The seller’s reorganisation should not prevent a sale of future receivables that arise prior to, or after, the reorganisation (especially if authorised by the receiver).
Accordingly, the situation described in this question is to be avoided.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under Moroccan law, depending on the type of assets and the legal status of the pledgor and the pledgee, additional or specific formalities might be required on a case-by-case basis.

5.6 Trusts. Does Morocco recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Morocco has not yet ratified the 1985 International Convention relating to the law applicable to trust and their recognition.

Accordingly, trusts are generally not recognised under Moroccan law.

There is, however, a mechanism stated in the Moroccan Securitisation Law, allowing the seller to continue to recover flows generated by the receivables transferred, the performance of guarantees and securities, on behalf of the management company of the FPCT.

5.7 Bank Accounts. Does Morocco recognise escrow accounts? Can security be taken over a bank account located in Morocco? If so, what is the typical method? Would courts in Morocco recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Morocco?

Escrow accounts could be used.

A security can be taken over a bank account located in Morocco.

The seller may grant a security interest on the balance of a bank account (nantissement de compte bancaire) in accordance with the principles applicable to pledges over receivables (nantissement de créances).

The law applicable to charges (sureties réelles) under Moroccan law is, as a matter of principle, the law of location (lex rei sitae) of the asset either movable or immovable.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The secured party would not control cash flowing into the bank account, but would only impede the debtor to use the funds.

However, the secured party would be able to take possession of the funds, once he obtains a final judicial decision ordering the bank to remit him the funds.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

No, the owner can have no such access.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Morocco’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

The commencement of insolvency proceedings (i.e. safeguard, reorganisation or liquidation proceedings) against the seller after the sale of receivables should not prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the receivables.

From an insolvency law point of view, the sale is valid and enforceable against third parties as from the date of the sale document, and qualifies as a true sale by virtue of law.

The sale of receivables by way of FPCT should not be affected by the commencement of Moroccan insolvency proceedings against the seller as such principle is clearly stated in the law.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

The insolvency official should not prohibit the exercise of rights by the purchaser of the receivables against the seller.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Morocco for (a) transactions between unrelated parties and (b) transactions between related parties?

In the context of reorganisation or liquidation proceedings, a sale of receivables may be challenged by the receiver during a so-called “suspect” period (période suspecte) of up to 18 months prior to the opening of insolvency proceedings if he considers that the insolvency dates back to a previous time.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Generally, the insolvency official of the seller cannot request a court
to order consolidation of the assets and liabilities of the purchaser with those of the seller or its affiliates, unless a court finds that there is an abnormal commingling of assets between the purchaser and the seller (confusion de patrimoines).

In these exceptional circumstances, the insolvency proceedings could be extended to the purchaser and would affect its assets.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Morocco, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

If insolvency proceedings are commenced against the seller in Morocco, sales of receivables that would otherwise occur after the commencement of such proceedings or sales of receivables that only come into existence after the commencement of such proceedings should not be affected.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Morocco establishing a legal framework for securitisation transactions? If so, what are the basics?

There is a special law establishing a legal framework for securitisation transactions: Law n. 33-06 published in the Official Bulletin on 20 November 2008. See the basics in the answer to question 7.2.

7.2 Securitisation Entities. Does Morocco have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The Moroccan Securitisation Law refers to the Fonds de Placements Collectifs en Titrisation (FPCT). The FPCT is a co-ownerships vehicle whose exclusive purpose is the acquisition of debt receivables.

The FPCT does not have separate legal personality. It may consist of several ring-fenced ‘compartments’.

The FPCT must be constituted jointly by a management company and a custodian.

The management company is a commercial management company with a minimum capital of MAD 1,000,000 and should obtain a licence from the “Conseil Déontologique des Valeurs Mobilières” (CDVM).

The custodian is a credit institution incorporated and approved by the Moroccan Government.

The management company and the custodian play an important role in the creation and the life of the FPCT, the former as manager of its business and the latter as custodian of the FPCT’s assets and as supervisor of the management company.

Moroccan legal provisions on securitisation provide that the FPCT is entitled to acquire debts secured by mortgages, debts of financial institutions, debts of insurance companies, debts of public entities and public affiliates, debts from companies receiving delegation to render public services, including existing or future receivables.

The law also provides the possibility for the FPCT to issue either shares (valeurs mobilières) or bonds (obligations) or (billets de trésorerie).

The FPCT should obtain the opinion of the (Conseil Déontologique des Valeurs Mobilières) CDVM for its draft management regulations, when it does not recourse to public offering and for the CDVM’s agreement when there is a recourse to a public offering. Managers should not be sentenced by a Criminal Court.

7.3 Non-Recourse Clause. Will a court in Morocco give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

The question as to whether contractual limitations on the droit de gage general (commonly referred as to “limited recourse clause”) is subject to differing doctrinal views, but no particular jurisprudence.

7.4 Non-Petition Clause. Will a court in Morocco give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from taking legal action against the purchaser or another person or from commencing an insolvency proceeding against the purchaser or another person?

A court in Morocco should not give effect to a contractual provision prohibiting the parties from taking legal action against the purchaser or another person or from commencing an insolvency proceeding against the purchaser or another person.

7.5 Priority of Payments “Waterfall”. Will a court in Morocco give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

A court in Morocco should not give effect to such contractual provision, as it is a matter of public policy.

7.6 Independent Director. Will a court in Morocco give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Under Moroccan law, organisational documents and/or any other contract may prohibit directors to take certain specified actions without the vote or consultation of another director appointed as independent director.

However, such provisions should not be enforceable against third parties.

Also, a restriction or limitation on the ability of the directors to bring insolvency proceedings contained in the Articles of Association of a company or in a contract entered into by a company should be invalid as a matter of public policy or incompatible with certain statutory duties of the directors.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Morocco, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Morocco? Does the answer to the preceding question change if the purchaser does business with other sellers in Morocco?

A purchaser must be licensed to purchase receivables. It makes no difference whether or not the purchaser does business with other sellers in Morocco.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

According to Moroccan Securitisation Law, the seller continues to be in charge of the recovery of receivables on behalf of the management company of the FPCT.

Servicing and collection activities for the benefit of third parties under Securitisation law must be notified to debtors.

8.3 Data Protection. Does Morocco have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The handling and processing of information on individuals is regulated by the Moroccan law on the Protection of Personal Data, Law n. 09-08 dated 18 February 2009.

The law only applies to individual obligors and not enterprises. Data controllers are subject to notification requirements to the National Commission of Control of Personal Data Protection: a prior authorisation in case of sensitive data or a prior notification in the absence of sensitive data.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Morocco? Briefly, what is required?

If the obligors are consumers, the purchaser as an assignee should comply with the consumer protection law and mainly for certain information to provide, abusive clauses and particular commercial practices.

8.5 Currency Restrictions. Does Morocco have laws restricting the exchange of Morocco’s currency for other currencies or the making of payments in Morocco’s currency to persons outside the country?

A transfer from Morocco to a person outside Morocco is subject to Moroccan Exchange Control Regulations.

According to these Regulations, any transfer of money abroad should be evidenced by commercial documents to be provided to the local bank in order to proceed to the transfer.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Morocco? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Withholding tax treatment of Moroccan receivables depends not only on their nature but on the recipient to whom they are paid.

Broadly, payments with a Moroccan source may be paid without withholding tax to a purchaser resident in Morocco.

Payments to a non-Moroccan resident purchaser may often be subject to withholding tax, subject to any available treaty relief pursuant to a non double tax convention.

9.2 Seller Tax Accounting. Does Morocco require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The Securitisation Law imposes a specific accounting policy fixed by the Administration against a FPCT and states also for the control of the CDVM.

9.3 Stamp Duty, etc. Does Morocco impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty exists in Morocco and is chargeable on documents in certain circumstances.

9.4 Value Added Taxes. Does Morocco impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Moroccan Value Added Tax (“VAT”) is chargeable on the supply of goods and services which take place in Morocco.

A transfer of financial receivables would generally be treated as an exempt supply for VAT purposes.

Fees payable for collection agent services are not exempt from VAT and will usually give rise to VAT at the standard rate to the extent they are treated as taking place in Morocco.

Local banks have general authority to do so for “opérations courantes”, common transactions.

Regarding a non common transaction, a specific authorisation from the Moroccan Exchange Office should be granted.

There is, however, no restriction from a local person/entity to receive money from a foreign entity. The funds received would be converted into Moroccan Dinarham according to the exchange rate of the foreign currency at the date of the transfer.
9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

No, the taxing authority would not be able to do so, for VAT if applicable, as it is the seller’s duty to pay it.

Stamp duty if applicable, depending on the type of the sale of receivables, is however put on the head of the purchaser.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Morocco, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Morocco?

The purchaser would have a Moroccan corporate income tax liability, if its effective management place is in Morocco or if the purchaser has a permanent establishment in Morocco.

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Benzakour Law Firm (BLF) is a major Moroccan business law firm founded in 1968.
It is a prominent and very reputable firm in Morocco.

It is widely regarded as a top law firm acting in upstream and downstream sides.

The firm offers a large and full portfolio in business law, with a particular focus on assistance to foreign investment and litigation.

The main areas of practice are: corporate; energy; aviation; real estate; labour; tax law and debt collection; litigation; and arbitration.

The firm was founded by Abdelaziz Benzakour. He is considered by his peers as a revered figure in the country. He was appointed by the King as Head of Morocco’s Mediator Institute in 2011. He is also a former Chief of the Casablanca and Moroccan Bars and is lauded as “one of the biggest figures of the Moroccan Bar, with lots of personality, charisma and a great reputation”.

Rachid Benzakour is the managing lawyer of the firm and receives much praise for his dynamism, reactivity and reponsiveness, knowlegde and skill.
1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

(a) No, it is not required under Dutch law that the debt obligation of the obligor to the seller be documented in, or evidenced by, a formal receivable contract in order for this debt obligation to be enforceable. If the existence of the debt receivable can be substantiated in any other way than by means of a formal receivable contract, such receivable can equally be enforced.

(b) An invoice can serve as such alternative, written proof of the existence of the receivable, subject to proof to the contrary by the obligor.

(c) In view of the fact that a creditor-obligor relationship can be assumed to exist even in the absence of a formal receivable contract, a receivable “contract” can be deemed to exist as a result of the behaviour of the parties.

1.2 Consumer Protections. Do the Netherlands’ laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) The Decree credit compensation (Besluit kredietvergoeding) contains provisions limiting the maximum interest to be charged by the lender. This Decree regulates the offering of the most common types of consumer credit (excluding, inter alia, mortgage loans) by companies and/or persons acting in the course of their profession or business to private individuals (consumers). As to credits and other receivables not covered by the Decree credit compensation, parties are, in principle, free to fix the rate of interest or, as the case may be, default interest. Although usury rules as such do not exist in the Netherlands, exorbitant interest rates may be held to contravene morality (bonos mores) or public order. Consequently, contract clauses that provide for such interest rates may be void or voidable. It might also be contrary to the principles of reasonableness and fairness to attempt to enforce usurious interest rate clauses. Compounding of interest is permissible in the Netherlands.

(b) Pursuant to section 6:119, or as the case may be, section 6:119a of the Dutch Civil Code (Burgerlijk Wetboek), damages due because of a delay in the payment of a sum of money consist of the statutory interest on that sum over the period during which the obligor is in default. Section 6:119a of the Dutch Civil Code applies to agreements between companies and/or persons acting in the course of their profession or business and which relate to the supply of goods or the provision of services. At the end of each year the sum for which the statutory interest is calculated is increased by the interest due over that year. The statutory interest is fixed by governmental decree. The amount of the damages actually suffered is irrelevant. The creditor is entitled to the statutory interest, unless the parties have agreed to an interest rate higher than the statutory rate.

(c) Consumers may cancel a distance contract (overeenkomst op afstand, e.g., a contract concluded over the internet or by telephone) without owing a fine and without giving reasons, during a period of 14 calendar days commencing on the day when that contract was concluded, or during a period of 14 calendar days commencing on the day when the consumer received the information that the company was required to supply. Consumers may cancel their credit contract, without owing a fine and without giving reasons, during a period of 14 calendar days commencing on the day when that contract was concluded, or during a period of 14 calendar days commencing on the day when the consumer received the information that the company was required to supply, irrespective of whether it is a distance contract (overeenkomst op afstand) or not. Besides, if a consumer has a credit contract for an indefinite period of time, the consumer may terminate the credit agreement and repay the outstanding amount thereunder at any time. If a notice period has been included, this notice period may not be longer than one month.

(d) Besides the provisions that limit the maximum interest to be charged by a lender in respect of consumer credits, there are several provisions protecting consumers. For example, pursuant to section 33 of the Dutch Consumer Credit Act (Wet op het consumentenkrediet), which regulates the providing of credit by companies and/or persons acting in the course of their profession or business to private individuals (consumers), a consumer credit contract is, inter alia, null and void if (i) the borrower has an obligation to enter into another agreement except if such borrower is free to choose its counterpart to such agreement, or (ii) the borrower has an obligation to assign or pledge to the lender its income, social security benefits or other similar payments as security for its payments under the relevant consumer credit contract. Consumer protecting provisions can also be found in the Dutch Civil Code. The Dutch Civil Code, for example,
contains extensive rules as to the information which should be provided to the consumer before entering into the contract and as to the contents of the contract. The Dutch Civil Code further contains a “black and grey” list of provisions that, if included in the general conditions applicable to a contract entered into with a consumer, are considered to be or deemed to be unreasonably onerous towards such consumer as a result of which the consumer is able to declare the relevant provision void. Each of the lists contains fourteen items amongst which the provision that excludes the consumer’s right to set-off any amount it owes to its counterparty with any amount it owes from such counterparty.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

No, in principle no other requirements apply when a government or government agency has entered into a receivables contract. It should be noted, however, that, according to the Dutch Civil Code, any rights to which a person is entitled pursuant to private law may not be exercised contrary to the written or unwritten rules of public law. Essentially, this means that if a government entity or agency exercises any rights to which it is entitled pursuant to rules or principles of private law, such entity always needs to act in accordance with so-called general principles of good management (algemene beginselen van behoorlijk bestuur), which should always serve as a guiding principle for government entities, and may even limit such government entity’s ability to act as it considers fit if doing so would constitute improper management. Furthermore, it should be noted that, according to well-established case law, a government entity or agency may not exercise any rights which it may have under private law to serve any public interests, to the extent that public law grants such entity sufficient powers to realise such public goals. To the extent that any public regulation does not sufficiently provide for such means, the exercise of such rights provided under private law may not thwart the public law provisions in an unacceptable manner.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the Netherlands that will determine the governing law of the contract?

If the parties to a contract have not specified the law applicable to such contract, the applicable law will be determined on the basis of article 4 of EC Regulation on the law applicable to contractual obligations of 17 June 2008 (“Rome I”). Article 4(1) specifies the applicable law for certain particular types of contract listed therein, such as a contract for the sale of goods (which shall be governed by the law of the country where the seller has his habitual residence), a franchise contract (which shall be governed by the law of the country where the franchisee has his habitual residence) and a distribution contract (which shall be governed by the law of the country where the distributor has his habitual residence). Where the contract cannot be categorised as being one of the specified types of contract, it will be governed by the law of the country where the party required to effect the characteristic performance (kenmerkende prestatie) of the contract has his habitual residence (article 4(2) of Rome I). There are certain exceptions to the aforementioned rules. Pursuant to article 4(3) of Rome I, if it appears, from all the circumstances of the case, that the contract is manifestly more closely connected (naauwst verbonden) with a country other than that indicated in article 4(1) or 4(2), the law of the other country shall apply. In addition, article 4(4) of Rome I stipulates that if parties to a contract have not specified the law applicable to such contract, the contract cannot be categorised as being one of the types of contract as specified in Rome I and in the absence of a characteristic performance of a contract, the contract should be governed by the law of the country with which it is most closely connected (naauwst verbonden). In order to determine the country to which the contract is more or most closely connected, the relationship between the contract in question and other contracts should be taken into account. Furthermore, Rome I contains some provisions with respect to the law applicable to contracts of carriage, consumer contracts, insurance contracts and individual employment contracts (articles 5 to 8 of Rome I). If a professional has entered into a contract with a consumer and there is no choice of law specified in the contract, pursuant to article 6(1) of Rome I, such contract will, despite the law applicable pursuant to article 4 of Rome I, be governed by the law of the country where the consumer has his habitual residence, provided that the professional pursues or directs his commercial activities in or to this country. If there is a choice of law specified in the contract with a consumer then this choice of law will not set aside the non-dispositive consumer protection rules of the law of the country in which the consumer has his residence. In the Dutch Civil Code, it is explicitly stated that if it concerns a credit agreement with a consumer, which has a close connection with one or more of the Member States of the European Union, the consumer protecting rules on the basis of the Consumer Credit Directive (Directive 2008/48/EC) cannot be set aside, irrespective of the law governing the credit agreement.

2.2 Base Case. If the seller and the obligor are both resident in the Netherlands, and the transactions giving rise to the receivables and the payment of the receivables take place in the Netherlands, and the seller and the obligor choose the law of the Netherlands to govern the receivables contract, is there any reason why a court in the Netherlands would not give effect to their choice of law?

No, the choice of Dutch law as the law governing the contract will be valid and binding and be recognised by a Dutch court.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in the Netherlands but the obligor is not, or if the obligor is resident in the Netherlands but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the Netherlands give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Under Dutch law, the seller and the obligor are free to choose the law to govern the receivable contract to be entered into by them, including the law of any relevant jurisdiction (other than the Netherlands) (“Foreign Law”), and this choice of law is valid and binding as between the seller and the obligor, except that a Dutch court may give effect: (i) to the extent that any term of the relevant receivable contract or any provision of Foreign Law applicable to such receivable contract is manifestly incompatible with the overriding mandatory provisions of the Netherlands or of another jurisdiction where the performance of
the relevant receivable contract takes place or must take place, such
overriding mandatory provisions; (ii) if all other elements relevant to
the situation at the time of the choice of law are located in the
Netherlands or in another jurisdiction, mandatory rules of Dutch law
or of the laws of another jurisdiction, if and insofar as, under Dutch law
or of the laws of that other jurisdiction, those rules must be applied
irrespective of the chosen law; and (iii) in case the Foreign Law is of a
jurisdiction which is not a Member State of the EU and all other
elements relevant to the situation at the time of the choice of law are
located in one or more Member State(s) of the EU, the mandatory rules
of European Community Law (gemeenschapsrecht), as implemented
by the relevant Member State(s), if and insofar as, such European
Community Law must be applied irrespective of the chosen law.

2.4 CISG. Is the United Nations Convention on the
International Sale of Goods in effect in the Netherlands?

Yes, as from 1 January 1991, the United Nations Convention on the
International Sale of Goods is in effect in the Netherlands.

3 Choice of Law – Receivables Purchase
Agreement

3.1 Base Case. Does the Netherlands’ law generally require
the sale of receivables to be governed by the same law
as the law governing the receivables themselves? If so,
does that general rule apply irrespective of which law
governs the receivables (i.e., the Netherlands’ laws or
foreign laws)?

Pursuant to Dutch private international law, the assignment of a
receivable will be governed by the chosen law of, or the law otherwise
applicable to, the agreement which contains the undertaking to assign
such receivable, irrespective of the law governing the receivable. The
law of the agreement containing the undertaking determines the
validity of the assignment of the receivable. However, the law
governing the receivable which is purported to be assigned determines
the topics set forth in article 14(2) of Rome I, being (i) the assignability
of the receivable, (ii) the relationship between the assignee and the
obligor, (iii) the conditions under which the assignment of the
receivable can be enforced against the obligor, as well as (iv) the
question whether the obligor’s obligations under the receivable have
been paid and discharged in full.

3.2 Example 1: If (a) the seller and the obligor are located in
the Netherlands, (b) the receivable is governed by the law
of the Netherlands, (c) the seller sells the receivable to a
purchaser located in a third country, (d) the seller and the
purchaser choose the law of the Netherlands to govern
the receivables purchase agreement, and (e) the sale
complies with the requirements of the Netherlands, will a
court in the Netherlands recognise that sale as being
effective against the seller, the obligor and other third
parties (such as creditors or insolvency administrators of
the seller and the obligor)?

Yes, a Dutch court would recognise an assignment of a receivable
executed between such seller and purchaser in accordance with
Dutch law, pursuant to a receivables purchase agreement which is
governed by Dutch law, as being effective against the seller, obligor
and other third parties (such as creditors or insolvency administrators of the seller and the obligor), subject of course to the
provisions of any applicable bankruptcy (faillissement), insolvency,
fraudulent conveyance (actio pauliana), reorganisation, suspension
of payments (surseance van betaling) and other laws of general
application in effect, relating to or affecting the enforcement or
protection of creditors’ rights.

3.3 Example 2: Assuming that the facts are the same as
Example 1, but either the obligor or the purchaser or both
are located outside the Netherlands, will a court in the
Netherlands recognise that sale as being effective against
the obligor and other third parties (such as creditors or
insolvency administrators of the seller), or must the
foreign law requirements of the obligor’s country or the
purchaser’s country (or both) be taken into account?

Yes, a Dutch court would recognise an assignment of a receivable
executed between such seller and purchaser in accordance with
Dutch law, pursuant to a receivables purchase agreement which is
governed by Dutch law, as being effective against the seller and
third parties (such as creditors or insolvency administrators of the
obligor) irrespective of whether or not the requirements for
assignment under the law of the obligor’s or purchaser’s (or both)
have been taken into account, subject of course to the
provisions of any applicable bankruptcy (faillissement), insolvency,
fraudulent conveyance (actio pauliana), reorganisation, suspension
of payments (surseance van betaling) and other laws of general
application in effect, relating to or affecting the enforcement or
protection of creditors’ rights.

3.4 Example 3: If (a) the seller is located in the Netherlands
but the obligor is located in another country, (b) the
receivable is governed by the law of the obligor’s country,
(c) the seller sells the receivable to a purchaser located in
a third country, (d) the seller and the purchaser choose the
law of the obligor’s country to govern the receivables
purchase agreement, and (e) the sale complies with the
requirements of the obligor’s country, will a court in the
Netherlands recognise that sale as being effective against
the seller and other third parties (such as creditors or
insolvency administrators of the seller) without the need
to comply with the Netherlands’ own sale requirements?

Yes, a Dutch court would recognise an assignment of a receivable
executed between such seller and purchaser in accordance with the
law governing the purchase receivables agreement as being
effective against the seller and third parties of the seller, irrespective
of whether or not the requirements for assignment under Dutch law
have been complied with, subject of course to the provisions of any
applicable bankruptcy (faillissement), insolvency, fraudulent
conveyance (actio pauliana), reorganisation, suspension of
payments (surseance van betaling) and other laws of general
application in effect, relating to or affecting the enforcement or
protection of creditors’ rights.

3.5 Example 4: If (a) the obligor is located in the Netherlands
but the seller is located in another country, (b) the
receivable is governed by the law of the seller’s country,
(c) the seller and the purchaser choose the law of the
seller’s country to govern the receivables purchase
agreement, and (d) the sale complies with the
requirements of the seller’s country, will a court in the
Netherlands recognise that sale as being effective against
the obligor and other third parties (such as creditors or
insolvency administrators of the obligor) without the need
to comply with the Netherlands’ own sale requirements?

Yes, a Dutch court would recognise an assignment of a receivable
executed between such seller and purchaser in accordance with the
law governing the purchase receivables agreement as being effective against the obligor and third parties of the obligor, irrespective of whether or not the requirements for assignment under Dutch law have been complied with, subject of course to the provisions of any applicable bankruptcy (faillissement), insololvency, fraudulent conveyance (actio pauliana), reorganisation, suspension of payments (surseance van betaling) and other laws of general application in effect, relating to or affecting the enforcement or protection of creditors’ rights.

3.6 Example 5: If (a) the seller is located in the Netherlands (irrespective of the obligor’s location), (b) the receivable is governed by the law of the Netherlands, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in the Netherlands recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the Netherlands and any third party creditor or insolvency administrator of any such obligor)?

Yes, a Dutch court would recognise an assignment of a receivable executed between such seller and purchaser in accordance with the law governing the purchase receivables agreement as being effective against the seller, any obligor located in the Netherlands and third parties of the seller and such obligor, subject of course to the provisions of any applicable bankruptcy (faillissement), insololvency, fraudulent conveyance (actio pauliana), reorganisation, suspension of payments (surseance van betaling) and other laws of general application in effect, relating to or affecting the enforcement or protection of creditors’ rights. However, Dutch law would determine the conditions under which such assignment can be enforced against the obligor (see the answer to question 3.1 above).

4 Asset Sales

4.1 Sale Methods Generally. In the Netherlands what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The customary method for a seller to sell receivables in the Netherlands would be a sale (verkoop) of such receivables by entering into a sale and purchase agreement with the purchaser followed by an assignment (cessie) of such receivables pursuant to which the purchaser becomes the legal owner of such receivables.

As set forth under question 4.2 below, Dutch law makes a distinction between the undertaking to sell a receivable constituting the title (titel) required for a valid transfer (overdracht) of a receivable and the delivery (levering) of such receivable (named assignment (cessie)) pursuant thereto.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Pursuant to section 3:84(1) of the Dutch Civil Code, the transfer of ownership of assets (which includes receivables) requires delivery (levering), pursuant to a valid title (geldige titel), by a person who has the power of disposal over the assets (beschikkingsbevoegdheid). The title required for the assignment of receivables may be constituted by a receivables purchase agreement between the seller and the purchaser. For the delivery of receivables, section 3:94(1) of the Dutch Civil Code requires: (i) a deed of assignment signed by the assignor and the assignee; and (ii) notification to the relevant obligors of the assignment. Pursuant to section 3:94(3) of the Dutch Civil Code, which was added to the Dutch Civil Code on 1 October 2004, an assignment of receivables can also be effected by means of a notarial or registered deed of assignment, without notification of the assignment to the relevant obligors being required, provided that such receivables exist at the time of registration or directly result from an existing legal relationship (rechtstreeks zullen worden verkregen uit een bestaande rechtsverhouding).

There are no additional perfection requirements for the sale of receivables which would protect the first transferee of such receivables against a possible further sale of the receivables by the seller to a later purchaser. The extent to which the first transferee of the receivables is protected against a later purchaser, who claims to be the rightful owner of such receivables, depends on the level of protection which a later purchaser of such receivables, who has acted in good faith in the purchase of such receivables, will be granted under Dutch law. Under the general third party protection clause, a third person who, on the basis of another’s declaration or conduct, assumes the creation, existence or extinction of a certain juridical relationship which is reasonable in the circumstances, and who acts reasonably in reliance on the accuracy of that assumption, cannot have the inaccuracy of that assumption invoked against him by the other person. Although it would technically be possible for a third party to be protected against the lack of power of disposition of the seller following the first transfer of the receivable, it will not be easy to comply with the above requirements in order to be so protected.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The law on negotiable instruments such as a promissory note is set forth in the Dutch Commercial Code (Wetboek van Koophandel). The relevant provisions of this Code reflect, for the most part, the terms of the 1930 and 1931 Geneva Conventions to which the Netherlands is party. However, it is of note that these statutory rules only apply to a promissory note payable to order (provided such instrument does contain the elements which are required according to the Dutch Commercial Code in order to qualify as a negotiable instrument within the meaning thereof). A promissory note payable to order must state the name of the person to whom or to whose order payment must be made. Under Dutch law a promissory note payable to order is transferred by means of physical delivery of the instrument to the endorsee (geëndosseerde) and an endorsement to be written on (the back of) the promissory note itself or on a slip affixed thereto (verlengstuk). Such delivery must be effectuated pursuant to a valid title by a person who has the power to dispose over the instrument.

A promissory note payable to bearer is governed by the principles of Dutch law regarding bearer instruments in general. A transfer of ownership of a bearer instrument requires a physical delivery pursuant to a valid title by a person who has the power to dispose of the instrument.
Pursuant to Dutch rules of private international law, the proprietary aspects (such as a transfer) of book-entry securities (girale effecten) held in a securities account with a bank or other entity, which is allowed to offer securities accounts to its customers are governed by the laws of the state in whose territory the relevant bank maintains the securities account to which such securities are credited. Such laws specifically determine (i) which proprietary rights can be vested in the securities as well as the nature and contents of such rights, (ii) the perfection requirements for a transfer of the securities or for the vesting of a proprietary right therein, (iii) who is entitled to exercise the rights attached to the securities, (iv) the manner in which the contents of proprietary rights in the securities can vary, the manner in which proprietary rights in the securities pass by operation of law (overgaan) and the manner in which proprietary rights in the securities terminate and what the mutual relationship is between various proprietary rights, and (v) how to foreclose upon the securities.

Under Dutch law, securities held through and registered with Euroclear Netherlands will be transferred in accordance with the Securities Giro Act (Wet Giraal Effectenverkeer or “Wge”) by means of a simple book-entry in the name of the purchaser at the relevant bank. There are no additional or different requirements for the sale and assignment of receivables resulting from consumer loans and mortgage loans.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

The assignment of receivables should be distinguished from the enforceability of such assignment against the obligors. With respect to the assignment of receivables, as set out in our answer to question 4.2, Dutch law requires a deed of assignment and (a) notification thereof to the obligors (assignment pursuant to section 3:94(1) of the Dutch Civil Code), or (b) registration of the deed of assignment with the Dutch tax authorities (assignment pursuant to section 3:94(3) of the Dutch Civil Code). Only in case of a disclosed assignment, i.e. (a), is notification required for an assignment of the receivables to be effective. As regards the enforceability of such assignment of receivables against the obligors of the receivables (in the way referred to above under question 4.2), notification of such obligors of such assignment will be required (both in case of a disclosed and non-disclosed assignment). Further, pursuant to section 7:69 of the Dutch Civil Code, which applies if it concerns consumer credit agreements, the consumer should be informed about an assignment. This rule, however, does not apply if the original credit provider will manage the credit agreement after the assignment.

Under Dutch law, the obligor’s consent as to an assignment of a receivable is not required, unless the relevant receivables contract does prohibit such assignment without the obligor’s consent, or contains other restriction clauses on the assignment of the receivables.

In case of a non-disclosed assignment, prior to notification being made, an obligor can only validly discharge its obligations (bevrijdend betalen) under the relevant receivable by paying to the seller. Any payments made by the obligor to the seller after the date on which the seller has been declared bankrupt (failliet verklaard) or has been granted a suspension of payments (surseance van betaling) (in case of such payments. This risk no longer exists after notification is made; as from that moment, the obligor can only validly discharge its obligations by making a payment to the purchaser.

Under Dutch law, a debtor has a right of set-off (verrekening) if he has a claim which corresponds to his debt to the same counterparty and he is entitled to pay his debt as well as to enforce payment of his claim. Unless the set-off right is effectively waived by an obligor in the underlying receivables contract, prior to notification being made, such obligor will, provided that the statutory requirements for set-off are met, be entitled to set-off any amounts due by the seller to it with any receivables owed by it to the seller.

After notification of the assignment, the obligor will have such right of set-off vis-à-vis the purchaser, provided that the statutory requirements for set-off are met, and further provided that (i) the counterclaim of the obligor results from the same legal relationship as the relevant receivable, or (ii) the counterclaim of the obligor has been originated (opgekomen) and become due (opgebaard) prior to the assignment of the receivable and notification thereof to the obligor. It is of note that, under Dutch law, a waiver of set-off rights is not enforceable in all circumstances, in particular not when the obligor qualifies as a private individual not acting in the course of its business or profession.

The relevant sections of the Dutch Civil Code do not contain any formal requirements as to how notification of an assignment to the obligor must take place or the form thereof. Notification may, in principle, even be done orally. However, it is advisable to deliver a notice in writing. A notification of an assignment will only be completed upon receipt by the obligor of the relevant notice, except if a failure to receive notice is deemed to be for the risk of such obligor (e.g., in case the obligor has changed location and did not inform its creditors thereof). It is possible to notify an obligor by one single notice of the assignment of any and all receivables which the seller currently has or in the future may acquire against such obligor.

Under Dutch law, the purchaser may notify the obligor of the sale and assignment of the receivables at all times, even after the bankruptcy (faillissement) or suspension of payments (surseance van betaling) of the seller or the obligor. However, it should be noted that, in case of an assignment pursuant to section 3:94(1) of the Dutch Civil Code, which requires notification, notification on or after the date the seller has been declared bankrupt (failliet verklaard) or granted suspension of payments (surseance van...
betaling verleend) will not be effective. Consequently, in such event, the legal ownership to the receivables will not pass to the purchaser. Furthermore, in case of an assignment pursuant to section 3:94(3) of the Dutch Civil Code, which requires notification to the obligors in order to prevent the obligors to validly discharge their obligations (bevrijdend betalen) under the receivables by paying to the seller, any payments made by the obligor to the seller after the date on which the seller has been declared bankrupt (failliet verklaard) or has been granted a suspension of payments (surseance van betaling verleend), will form part of the bankruptcy estate of the seller, albeit that the purchaser will be a ‘creditor of the estate’ (boedelschuldeiser) in respect of such payments.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in the Netherlands? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the Netherlands recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Under Dutch law, restrictions in receivables contracts prohibiting sale or assignment are generally enforceable. It does not make a difference if a contract is entered into with commercial entities or with persons not acting in the course of their profession or business. In the event that a receivables contract, which is governed by Dutch law, does prohibit assignment of the receivables, or otherwise contains restriction clauses on the assignment of such receivables, this would affect the validity of the assignment of such receivables because, under Dutch private international law, the question of whether a receivable is transferable is governed by the law governing such receivable. This means that if the receivables contract prohibits assignment or otherwise contains any restrictions on the assignment of receivables, this would affect their transferability. For the avoidance of doubt, a breach of a restriction clause would affect the transfer itself; in other words there will be no valid transfer of the relevant receivables. Therefore, the question whether the seller will be liable for breach of contract is not relevant.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

It is a Dutch law requirement that the receivables to be assigned pursuant to a deed of assignment are identifiable on the basis of such deed. According to case law, this requirement is satisfied if the deed does contain such details in respect of the relevant receivables that one can determine which receivables the parties have intended to assign. In order to avoid any discussions (either between the parties, or more in particular with any bankruptcy trustee) as to whether or not certain receivables have been validly assigned, it is preferred that as much detail as possible is included in the deed of assignment (such as invoice numbers). However, based on case law, it is possible to make use of a more general description, e.g. all receivables that are recorded in the books of the seller on the date of assignment.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redeemption without jeopardising perfection?

Under Dutch law, legal title to a receivable will pass to the purchaser if such receivable is validly delivered by the seller pursuant to a valid title (geldige titel) and the seller had the power of disposal (beschikkingsbevoegdheid) over such receivable. Upon the purchaser becoming the legal owner of the receivable, the receivable becomes part of the purchaser’s estate. In principle (i.e. subject to fraudulent conveyance and similar principles of Dutch law), the creditors of the seller (or its insolvency official) would not be able to recover receivables that have become part of the purchaser’s estate.

In relation to the requirement of a valid title (geldige titel), being the obligation for the seller to sell and assign the receivable, generally to be constituted by a receivables purchase agreement, we first note that according to a judgment of the Netherlands Supreme Court dated 13 March 1981 (HR 13 March 1981, NJ 1981, 635, Haviltex) the intention of the parties is of great importance to assess and interpret the terms and conditions of an agreement. If it is the intention of the parties involved to have a sale and assignment of a receivable and such is stipulated in the receivables purchase agreement, this will most likely be respected by a court. However, only in cases where it is evident that the intention of the parties is different from what is stated in the agreement, which is dependent on all relevant circumstances (including the economic characteristics of an agreement), a court could come to the conclusion that no sale and assignment of the receivable is foreseen and that a valid title for the assignment of the receivable is missing. Secondly, we note that section 3:84(3) of the Dutch Civil Code provides that an agreement which purports to transfer an asset as security for a liability or which does not purport the transferred assets to become part of the assets of the transferee, does not constitute a valid title. The fact that it has been agreed between the seller and the purchaser that the seller retains the whole credit risk related to the assigned receivables, that the purchaser is entitled to re-transfer all defaulted or uncollectable receivables to the seller or that the seller is entitled to repurchase the assigned receivables may, depending on the circumstances, involve the risk that the sale agreement is not considered to constitute a valid title. However, this risk is considered to be remote since case law, in particular the judgment of the Netherlands Supreme Court dated 19 May 1995 (HR 19 May 1995, NJ 1996, 119, Mr. Keereweer q.q. Sogelease) has limited the effects of the restrictions resulting from section 3:84(3) of the Dutch Civil Code considerably. According to this judgment, only the transfer of ownership for the sole purpose of protecting the interests of the transferee as a creditor of the transferor constitutes an invalid title (fiducia cum credito).
4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, a seller may agree to a sale of all receivables that it currently owes and may owe in the future, subject of course to provisions of any applicable insolvency, fraudulent conveyance (actio pauliana) and other laws of general application in effect at the time of the agreement or thereafter, relating to or affecting the enforcement or protection of creditor’s rights.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Under Dutch law, a receivable which does not exist yet may be sold and assigned in advance (bij voorbaat) by the seller so that the purchaser automatically becomes the owner thereof when it comes into existence, provided that the receivable is sufficiently identified in the deed of assignment and the requirements for the transfer of ownership are met. If the assignment is effected pursuant to section 3:94(1) of the Dutch Civil Code, the assignment of a “future” receivable has to be notified to the relevant obligors and, if the assignment is effectuated pursuant to section 3:94(3) of the Dutch Civil Code, the legal relationship from which such receivable results must already exist at the time of the assignment in advance. However, it is of note that an assignment of a future receivable will not be effective to the extent that the receivable comes into existence after or on the date on which the seller has been declared bankrupt or has had a suspension of payments granted to it.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

No additional formalities need to be fulfilled if the related security qualifies as an accessory right (afhankelijke recht) in the meaning of section 3:7 of the Dutch Civil Code and/or ancillary right (nevenrecht) in the meaning of section 6:142 of the Dutch Civil Code, such as a mortgage right, right of pledge or suretyship (borgtocht). Pursuant to section 3:82 of the Dutch Civil Code, accessory rights and ancillary rights follow the right with which they are connected. Consequently, if a receivable is assigned, in principle the accessory rights and the ancillary rights pass by operation of law to the assignee of the receivable upon completion of the assignment, except if the relevant right by its nature is, or has been construed by the parties as, a purely personal right of the assignor. If a security right is not solely granted to secure a particular receivable, but secures also other amounts that are or may become due by the relevant obligor, it is not entirely certain whether upon assignment of the receivable such security right follows the relevant receivable.

5 Security Issues

5.1 Back-up Security. Is it customary in the Netherlands to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No, it is not customary in Dutch transactions involving a sale of receivables to take up such a “back-up” security interest.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the Netherlands, and for such security interest to be perfected?

See the answer to question 5.1 above.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the Netherlands to grant and perfect a security interest in purchased receivables governed by the laws of the Netherlands and the related security?

A right of pledge over receivables (including, without limitation, accounts receivable) is created by the execution of a deed of pledge. Under Dutch law, a right of pledge over receivables can either be a disclosed pledge (openbaar pandrecht), in which case the obligor of the pledged receivables is given notification of the pledge, or an undisclosed right of pledge (stil pandrecht), in which case the obligor is not notified of the pledge. However, in order to create a valid undisclosed right of pledge, the relevant deed of pledge must be in the form of a notarial deed executed before a Dutch civil law notary, or registered with the appropriate unit of the Dutch Tax Revenue Service.

No statutory provision exists on the issue whether, upon the creation of a right of pledge over a receivable and notification thereof to the relevant obligor, the pledgee is entitled to exercise the accessory rights and the ancillary rights connected to the receivable upon the exercise of the right of pledge. However, the majority view is that, if a right of pledge is created over a contractual right which itself is secured by a mortgage or a pledge, the pledgee is entitled to exercise the rights of the relevant pledgor under such mortgage or pledge, provided such right of mortgage or pledge is disclosed to the relevant obligor.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the Netherlands, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in the Netherlands?

The statements made above under question 3.1 apply mutatis mutandis. This means that the granting of security right over a receivable will be governed by the chosen law of, or the law otherwise applicable to, the agreement which contains the undertaking to grant a security right over such receivable, irrespective of the law governing the receivable. The law of the agreement containing the undertaking determines the validity of the granting of a security right over the receivable. However, the law governing the receivable over which a security right is purported to
be granted determines (i) whether the receivable is capable of being encumbered, (ii) the relationship between the grantee of the security right and the obligor, (iii) the conditions under which the granting of a security right over the receivable can be enforced against the obligor, as well as (iv) the question whether the obligor’s obligations under the receivable have been paid and discharged in full.

It is of note that there is no conclusive case law in the Netherlands with respect to the enforcement by the Dutch courts of security rights established under and governed by a law other than Dutch law. However, from Dutch case law as it currently stands, the following can be deduced: the foreclosure and ranking of security rights in the Netherlands will be subject to Dutch law, which has a fixed system and a mandatory ranking of security rights. Subject to the exceptions to the validity of the choice of the purchaser’s country or a third country (other than the Netherlands) and the above paragraph, such foreign security rights will be recognised in the Netherlands, without any additional steps being required. If recognised, a foreign security right will be enforced, and have the same ranking, as the Dutch security right which most closely resembles such foreign security right. This means that the secured party will not have more rights than it would have had if Dutch law had governed such foreign security right.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under Dutch law, a right of pledge over a promissory note payable to the bearer is created by the pledgor and the pledgee entering into a deed of pledge, and by the physical delivery of the instrument to the pledgee or a third party agreed upon by the pledgor and the pledgee. A right of pledge over a promissory note payable to order is created in the same manner, provided that in addition to that, an endorsement is written on (the back of) the promissory note itself or on a slip affixed thereto (verlengstuk).

If the marketable debt securities held by the seller are cleared through and registered with Neocigef pursuant to the Wge, then a pledge over these securities is effectuated by means of a simple book-entry in the name of the pledgee in such bank’s records. As is the case with the transfer of marketable debt securities cleared through and registered with foreign clearing institutions (see question 4.3 above), in principle, the creation of a security interest in such securities will also be governed by the laws of the location of such institution. We note however that, pursuant to Dutch rules of private international law, the law governing the creation of a security interest in securities held in a securities account with a bank or other entity, which is allowed to offer securities accounts to its customers, is the laws of the state in whose territory the relevant bank maintains the account to which such securities are credited.

There are no additional or different requirements for the creation and perfection of a right of pledge over receivables resulting from consumer loans and mortgage loans.

5.6 Trusts. Does the Netherlands recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Dutch law does not know the legal concept of trusts. However, under Dutch law, pursuant to the Trust Convention, a trust created in accordance with the chosen law, will be recognised by the courts in the Netherlands, provided that the chosen law provides for trusts and the trust has been created voluntarily and is evidenced in writing. Pursuant to section 13 of the Trust Convention, the courts in the Netherlands will, however, not be bound to recognise a trust, the significant elements of which are more closely connected with states which do not provide for the institution of the trust. As an alternative to a trust, a bankruptcy remote foundation may be used, which is incorporated for the sole purpose of managing and distribution of certain amounts received by it to the persons who are entitled to receive such amounts in accordance with the object clause in its articles of association.

5.7 Bank Accounts. Does the Netherlands recognise escrow accounts? Can security be taken over a bank account located in the Netherlands? If so, what is the typical method? Would courts in the Netherlands recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the Netherlands?

Dutch law does not know the legal concept of escrow accounts. However, regular bank accounts in which amounts are credited which have a special purpose are being used frequently (especially in case of a sale and transfer of real estate). In case such an account is maintained by a notary and qualifies as a so-called designated account (kwaliteitsrekening), the amounts standing to the account are separated from the estate of the notary.

A right of pledge over accounts receivables is generally created as a disclosed pledge (openbaar pandrecht) by the execution of a deed of pledge and notification thereof to the account bank. It should be noted that, pursuant to the general banking conditions (algemene bankvoorwaarden), the account bank generally retains a right of pledge in respect of the account and that, in case a first ranking right of pledge over account receivables is envisaged, the account bank should be contacted and requested to waive the right of pledge created in favour of the account bank.

As to the recognition of a foreign law security right in respect of a bank account located in the Netherlands, see the answer to question 5.4 above.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

In principle, all present and future accounts receivables of the account owner against an account bank are subject to the disclosed pledge (openbaar pandrecht) after notification of such financial institution. An undisclosed right of pledge (stil pandrecht) does not cover future accounts receivables, but is limited to the amounts standing to the account at the time the right of pledge is vested. As a result, in case of an undisclosed right of pledge the owner of the account (the pledgor) has access to the funds in the account even after enforcement of the pledgee’s undisclosed right of pledge. Therefore, it is preferable to create a disclosed right of pledge over the accounts receivables as such limitation does not apply to enforcement of a disclosed pledge.

Pursuant to section 3:246(1) of the Dutch Civil Code the pledgee is entitled to collect the pledged accounts receivables in and out of court. The account bank can only validly discharge its obligations (bevrijdend betalen) by paying the pledgee. When a pledged claim is collected by the pledgee, the right of pledge is automatically
vested on the collection proceeds. Pursuant to section 3:255 of the Dutch Civil Code the pledgee is entitled to recover his claim from the collection proceeds as soon as his claim has become due and payable. Until the claim has become due and payable, the collection proceeds must be held separated from the pledgee’s private estate. The pledgee and the account owner (pledgor) could agree in the deed of pledge that as soon as the pledged claim becomes due and payable, the claim of the pledgee will become due and payable for an equal amount as the pledged claim.

The right to demand payment in and out of court and to collect the pledged accounts receivables stays with the account owner (pledgor) as long as the account bank is not notified of the right of the pledgee. Hence, in case an undisclosed right of pledge (stil pandrecht) is created over the accounts receivables, the pledgee is only entitled to demand payment and to collect the pledged accounts receivables after notification of the right of pledge to the relevant obligor.

A pledge over a bank account will not cover any payments that are made into the bank account after bankruptcy (faillissement) of the owner of the account (pledgor).

### 6 Insolvency Laws

#### 6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the Netherlands insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the seller of receivables under Dutch law becomes subject to insolvency proceedings following the sale and transfer of ownership rights in such receivables, the purchaser of these receivables is free to exercise any ownership rights over the receivables (including collection and transfer). Dutch law is not familiar with any “automatic stay” provisions which a purchaser would have to comply with following an effective sale and transfer of receivables (or a true sale, if you like) in such circumstances.

It should be noted in this respect that Dutch law makes a distinction between 'existing' and 'future' receivables: if receivables are to be regarded as future receivables, a sale and transfer will be ineffective to the extent that the receivables come into existence on or after the date on which the seller has been declared bankrupt or has had a suspension of payments granted to it (see question 4.10 above). The purchaser will, in that case, not be able to exercise any ownership rights as such rights have not been effectively transferred to it.

Furthermore, if the assignment of the receivables was effected by means of a notarial deed or registered deed of assignment without notification being made to the obligors (see question 4.2), until such notification to the obligors has been made, such obligors can only validly discharge their obligations (bevrijdend betalen) under the relevant receivables contract by making a payment to the seller. Payments made by the obligors to the seller prior to notification but after bankruptcy or suspension of payments in respect of the seller having been declared, will be part of the seller’s bankruptcy estate.

However, the purchaser has the right to receive the amounts paid by the obligors by preference after deduction of the general bankruptcy costs (algemene faillissementskosten). Notification to the obligors of the transfer of legal title can still be validly made after the seller has been declared bankrupt or has been granted a suspension of payments. After such notification, the obligors are required to make the payments under the relevant receivables contracts to the purchaser.

In case the purchaser is granted a right of pledge over the receivables, the purchaser, as pledgee, may act “as if there were no bankruptcy” and foreclose its right of pledge. A right of pledge over receivables governed by Dutch law may be enforced by collection of such receivables (after notice of the right pledge to the relevant obligor) and applying the net proceeds of such sale in satisfaction of the payment obligations secured by such pledge or by having the receivables sold in a public auction or by a private sale and applying the net proceeds of such auction or sale towards satisfaction of the payment obligations secured by such pledge, all with due observance of the applicable provisions of Dutch law.

It should be noted that the court may, in the case of a suspension of payments and a bankruptcy, for a period of two months with a possible extension of two months, order a general stay (a so-called cool down period (afkoelpériode)) during which secured creditors, such as a holder of a pledge over receivables, may only foreclose its right of pledge after having obtained the approval of the administrator (in case of suspension of payments) or the bankruptcy trustee (in case of bankruptcy). It is noted that the ordering of a cool down period does not prevent the collection by the pledgee of amounts due under the receivables, but only the application by the pledgee of the proceeds thereof towards satisfaction of the payment obligations secured by the right of pledge during the cool down period.

Furthermore, in the case of bankruptcy, under the Dutch Bankruptcy Code (Faillissementswet), a bankruptcy trustee may determine a reasonable period within which pledgees and mortgagees must foreclose their security rights. If a pledgee or mortgagee fails to do so, the bankruptcy trustee may sell the assets subject to the security right himself in a manner provided for in the Dutch Bankruptcy Code (Faillissementswet). It is not certain whether this provision applies to a pledgee of intangible assets,
such as receivables. In legal literature, it has been argued that this provision is not applicable to a pledge over receivables, since it only refers to sale of assets subject to a right of pledge or mortgage and not to a collection of receivables and, furthermore that the exercise of collection powers which pass to the pledgee upon notification, cannot by its nature be limited to a period.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

In the absence of any “automatic stay” provisions under Dutch law, and assuming the sale and transfer of the ownership rights in the receivables would be effective, the insolvency official could seek to prohibit the exercise of such ownership rights by the purchaser by having the sale and transfer of the receivables to the purchaser avoided under the Dutch fraudulent conveyance provisions. Alternatively, such insolvency official could try to avoid the sale and transfer on the basis of general defences under Dutch law in respect of the validity and enforceability of contractual obligations, such as avoidance on the grounds of duress (bedreiging), deceit (bedrog), undue influence (misbruik van omstandigheden) or mistake (dwaling).

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the Netherlands for (a) transactions between unrelated parties and (b) transactions between related parties?

The insolvency official may try to void voluntarily executed transactions, provided he can establish that both parties to the transaction – seller and purchaser – knew or should have known that the transaction would have the effect of decreasing the amount which the seller’s creditors would have received, had the sale and transfer of the receivables to the purchaser not taken place. Such knowledge is presumed by law, subject to proof to the contrary, for all transactions performed within one year prior to an adjudication of bankruptcy of the seller, and provided it can also be established that the transaction falls within one of the following categories:

(i) the seller received substantially less than the estimated value of the assets sold;
(ii) the transaction was entered into by the seller as a natural person, with certain of its next of kin;
(iii) the transaction was entered into by the seller as a legal entity with members of its management board and/or supervisory board and/or its shareholders and some of each of their next of kin; or
(iv) the transaction was entered into by the seller as a legal entity with a group company.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Dutch law is not familiar with the concept of “consolidation of assets and liabilities” of the purchaser with those of the seller. If the sale and transfer of the receivables is perfected under Dutch law and the purchaser has obtained full legal title to such receivables, the insolvency official in the seller’s insolvency will not be able to consolidate assets and liabilities of the purchaser with those of the seller. Should the sale and transfer of the receivables not be perfected prior to the insolvency of the seller, the receivables will fall in the seller’s bankruptcy. As a practical matter, however, a bankruptcy trustee in a Dutch bankruptcy would sometimes apply consolidation of assets and liabilities, e.g. in the event that affiliated entities are declared bankrupt (i.e. a parent company and its subsidiaries), there would be a strong interrelationship among these entities (i.e. because of joint and several liability arrangements between these entities) and such consolidation would not be harmful to the interests of creditors, taking into account that the consolidation would save the costs of making a distinction between the asset and debt position of the individual entities. On the basis of the Netherlands Supreme Court dated 25 September 1987 (HR 25 September 1987, NJ 1988, 136, Van Kempen en Beeger vs. the bankruptcy trustees of Zilfa and DCW), it can be deducted that a consolidation of the bankruptcies of various entities is allowed in the event that the assets and liabilities of such entities are intermingled to such extent that it would basically be impossible to separate these.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in the Netherlands, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Under Dutch law, future receivables can be assigned in advance (bij voorbaat) by the seller to the purchaser, provided that such receivables directly result from a legal relationship existing at that time, if it concerns an assignment which is effected pursuant to section 3:94(3) of the Dutch Civil Code. However, if such future receivables come into existence after the moment that the seller has been granted a suspension of payments or has been declared bankrupt, the assignment of such receivables cannot be invoked against the bankrupt estate (boedel). The receivables will then fall within the bankrupt estate of the seller.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the Netherlands establishing a legal framework for securitisation transactions? If so, what are the basics?

No such laws exist.

7.2 Securitisation Entities. Does the Netherlands have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No such laws exist. Typically, an issuer in a securitisation is incorporated as a straightforward private company with limited liability (besloten vennootschap met beperkte aansprakelijkheid) under Dutch law, the shares in which are held by a foundation (stichting). In its ‘Decree on Securitisation Wft 2010’ (Regeling securitisaties Wft 2010), the Dutch Central Bank (De Nederlandsche Bank N.V.) has set as requirements for credit
Institutions to be able to qualify under solvency relief provisions in relation to securitisation transactions, *inter alia*, that:

(i) the originating credit institution may not hold any share capital or other form of proprietary interest in or control over the issuing special purpose entity;

(ii) the issuer is not in any way affiliated to the originator; and

(iii) the name of the issuer does not include the name of the originator nor implies any connection with it.

7.3 Non-Recourse Clause. Will a court in the Netherlands give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

Generally, limited recourse provisions are valid and enforceable under Dutch law. Section 3:276 of the Dutch Civil Code even provides a legal basis for such provisions where it states that a creditor has recourse on all assets of a obligor unless provided otherwise by law or by contract.

If the contract is governed by a law other than Dutch law, a Dutch court would give effect to such contractual provision in accordance with the rules of the relevant law.

7.4 Non-Petition Clause. Will a court in the Netherlands give effect to a contractual provision (even if the contract's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Yes, such contractual provisions would in principle be valid and enforceable under Dutch law. If any of the other parties to such contractual arrangement took legal action against the special purpose entity or commenced insolvency proceedings against it, in violation of the contractual obligation not to, the other party or parties to such contractual arrangement could initiate proceedings against the 'violator' and claim compensation for damages, if any, suffered by them due to the special purpose entity being declared bankrupt. However, under Dutch law, any contractual restrictions imposed on a party to a contract to institute or join any other person in instituting insolvency proceedings against the special purpose vehicle will not result in such party becoming legally incompetent to institute or join any person in instituting such proceedings. It is, therefore, possible that a Dutch court would deal with a petition for bankruptcy (faillissement) in respect of the purchaser or such other person, notwithstanding that such petition has been presented in breach of a non-petition covenant. The court, when dealing with such petition, may come to the conclusion that the purchaser or such other person has ceased to pay its debts as they fall due (being the legal ground for bankruptcy in the Netherlands). A Dutch court may also deal with a petition for suspension of payments (*surséance van betaling*).

If the contract is governed by a law other than Dutch law, a Dutch court would give effect to such contractual provision in accordance with the rules of the relevant law.

7.5 Priority of Payments "Waterfall". Will a court in the Netherlands give effect to a contractual provision (even if the contract's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

A contractual provision pursuant to which payments are distributed to parties in accordance with a priority of payments as set forth in a contract are legal, valid and binding obligations enforceable as a matter of Dutch law as between the parties that have agreed thereto.

If the contract is governed by a law other than Dutch law, a Dutch court would give effect to such contractual provision in accordance with the rules of the relevant law.

7.6 Independent Director. Will a court in the Netherlands give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

There is no reason why such limitation on the competence of the management of the relevant entity would not be valid and enforceable against it. If such limitation is violated by the management board, the special purpose entity could hold the management personally liable for damages, if any, suffered by the special purpose entity due to the violation.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the Netherlands, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business in the Netherlands?

Under the Act on the Financial Supervision (Wet op het financieel toezicht) (the “Financial Supervision Act”), which entered into force on 1 January 2007, financial services providers, including offerers and brokers of financial products such as consumer loans, mortgage loans and any form of credit, are subjected to licence requirements and continuous conduct supervision by the Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten, the “AFM”). In addition, pursuant to the Financial Supervision Act, a person who becomes the legal owner of loan receivables and consequently services (beheert), or who administers (uitvoert) such loan receivables, would be required to have a licence as of the moment legal title was transferred to it. If the purchaser of the receivables is a licensed credit institution, it holds such a licence under the Financial Supervision Act by law. If a special purpose company or other entity acts as purchaser of such loan receivables, it will be exempt from obtaining a licence under the Financial Supervision Act if it has outsourced the servicing of the loan receivables and the administration thereof to an entity holding a licence under the Financial Supervision Act. The above licence requirements do not apply with respect to receivables that do not qualify as a financial product within the meaning of the Financial Supervision Act. The purchase, ownership, collection and/or enforcement of such receivables do not result in the purchaser becoming subject to the Financial Supervision Act or otherwise being required to qualify to do business in the Netherlands.

The above answer will not change when the purchaser does business with other sellers in the Netherlands.
8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

See the answer to question 8.1 above.

8.3 Data Protection. Does the Netherlands have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes, the use or dissemination of data about or provided by obligors may be subject to the provisions of the Dutch Data Protection Act (Wet Bescherming Persoonsgegevens). This act contains provisions with respect to the processing of personal data, ‘personal data’ being information on private individuals or information which can be traced back to private individuals, and ‘processing’ including the dissemination or transfer of such data amongst or to third parties. The act sets requirements on the way personal data should be collected and states that such collection is only allowed if any of the limitative grounds for assembling such information as mentioned in the Act apply. Furthermore, the Act indicates what requirements on quality need to be met, which reporting requirements exist and what rights the individuals whose information is collected may exercise towards the data collector in relation to such data collection.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the Netherlands? Briefly, what is required?

With a view to protect the interests of consumers, there are certain limitations and restrictions in relation to consumer loans and underlying contracts (see also question 1.2 above). There are, for example, certain (continuing) information obligations in relation to the customer such as that the credit provider, on the request of the customer, must provide the customer with a specified overview of the outstanding balance. The rules maximising the interest to be charged by the lender also apply. Further, the customer should be allowed to perform an advanced repayment of the loan. The sale and assignment by the seller of the receivables resulting from consumer loans will be without prejudice to the rights and the protection afforded by Dutch law to the relevant borrowers. In addition the provider of the consumer loan will be subject to certain licence requirements (see question 8.1 above).

8.5 Currency Restrictions. Does the Netherlands have laws restricting the exchange of the Netherlands currency for other currencies or the making of payments in the Netherlands currency to persons outside the country?

On 1 July 2012, the Money Transactions Offices Act (Wet inzake de geldtransactiekantoren) was repealed and the law regarding money transaction offices was included in the Financial Supervision Act. As of that date, everyone who, in the course of its business, performs exchange transactions qualifies as an exchange office (wisselinstitelling). It is not allowed to perform exchange transactions without having obtained a licence from the Dutch Central Bank.

Under the External Financial Relations Act 1994 (Wet financiële betrekkingen buitenland 1994) and the balance of payments reporting instructions 2003 (Rapportagevoorschriften betalingsbalansrapportages 2003), the Dutch Central Bank may appoint entities which have to report to the Dutch Central Bank in order to allow it to compile the national balance of payments. This means that the Dutch Central Bank makes sure that there is an accounting record of all monetary transactions between the Netherlands and other countries. In connection therewith, the Dutch Central Bank periodically collects data from groups of reporting entities selected by the Dutch Central Bank relating to, among others, cross-border transactions.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligor to the seller or the purchaser be subject to withholding taxes in the Netherlands? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

In principle, no withholding tax will be due in the Netherlands, unless the rules on hybrid debt apply. These rules, however, do not normally apply in relation to securitisation transactions.

9.2 Seller Tax Accounting. Does the Netherlands require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No specific accounting policy needs to be applied for tax purposes in the Netherlands.

9.3 Stamp Duty, etc. Does the Netherlands impose stamp duty or other documentary taxes on sales of receivables?

The Netherlands does not levy stamp duty, registration tax, transfer tax or other similar taxes on sales of receivables. However, Dutch real property transfer tax may be due if the receivables represent an interest in, or rights over, real property situated in the Netherlands. In practice, the latter does not generally apply.

9.4 Value Added Taxes. Does the Netherlands impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The supply of goods and services is VAT-taxed in the Netherlands if, according to the rules for the place of supply, the services are deemed to be rendered in the Netherlands and no exemption is applicable.

The transfer of receivables in the context of a Securitisation transaction is VAT-exempt, as a result of which no VAT is due on the transfer. If a taxable person, who is generally entitled to deduct VAT, transfers receivables in such transaction, the transfer should not have adverse consequences with respect to the transferor’s general right to deduct VAT on costs.

Collection agent services are, in principle, taxed with VAT. However, on the basis of guidance of the State Secretary of Finance, such services may be treated as VAT-exempt insofar as the services constitute collection from non-defaulting debtors.
Furthermore, the transferee may render a VAT-taxed service in case of factoring. The ECJ has ruled in the MKG-Kraffahrzeuge-Factoring case, (26 June 2003, C-305/01), that an economic activity whereby an entrepreneur purchases debts, is assuming the risk of the debtor’s default and in return invoices its clients in respect of commission, constitutes debt collection and factoring which is VAT taxed. In this respect, the ECJ has ruled in the GFKL Financial Services case (27 October 2011, C-93/10) that a transfer of receivables, in itself, does not imply a factoring service from the perspective of the transferee. Pursuant to the guidance of the State Secretary of Finance (Infobulletin 87/1974), factoring is considered as a VAT-taxed service if it concerns a continuing agreement in addition to which the entrepreneur is committed to take or all the risks of collecting the receivables. The incidental purchase of receivables does not qualify as factoring.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

If the seller is required to pay the VAT, it is not possible to make claims against the purchaser. The seller, and not the purchaser, is the VAT-taxable person. No stamp duty will be due.

9.6 Doing Business. Assuming that the purchaser conducts no other business in the Netherlands, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the Netherlands?

Non-residents will not generally become liable to Dutch income tax or corporation tax, as the case may be, by virtue only of the purchase of receivables or the appointment of a servicer or collection agent, in respect of a securitisation transaction.
### 1 Receivables Contracts

#### 1.1 Formalities

In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

- (a) There are no requirements to the form of a debt obligation except in certain special areas of contract law such as consumer credit agreements, enforceable promissory notes, letters of credits and cheques, etc.
- (b) An invoice will normally suffice to create an enforceable debt obligation and ordinary invoices will normally be the only evidence of a trade receivable, but standard trading terms may be, and often are, enclosed with invoices. If the creditor uses only invoices there is of course the risk that the buyer contests the invoice, in which case a seller may have to show evidence as to what has been delivered to the buyer in order to enforce the payment of the invoice.
- (c) An oral promise to pay or acceptance of an obligation to pay will create an enforceable obligation to pay, and obligations may likewise be created by the behaviour and customary actions of the parties. Needless to say, oral agreements or agreements based on behaviour or customary relationship between the parties can be difficult to prove in a dispute on whether an obligation to pay has been created or not.

#### 1.2 Consumer Protections

Do Norwegian laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

- (a) No, except for usury provisions in the Norwegian Penal Code, there are no laws fixing a maximum interest rate.
- (b) The Norwegian Interest on Late Payment Act provides creditors with a statutory right to demand default interest on late payments. The late payment interest rate is set semi-annually and is currently at 8.50 per cent. The rate shall be set at the Norwegian Central Bank’s lending rate plus a margin of at least 7 per cent. If the parties have agreed a different interest rate, that agreed rate may be applied.
- (c) A consumer obligor can turn away or terminate the credit agreement within 14 calendar days from the date of the agreement from the date the consumer received the prescribed credit information about the terms of the credit.
- (d) The Financial Contract Act Chapter 3 and regulations issued by virtue of the Act contain detailed regulations of consumer credits. Of noteworthy rights, we mention that the consumer obligor must consent to the transfer of the loan to another entity than a finance institution (typically it must consent to the transfer to a SPV). The credit agreement must be in writing, the consumer obligor has the same set off rights to a transferee as the consumer had towards the originator. The credit cannot be expressed in a negotiable document as that would prevent the consumer’s set off rights.

#### 1.3 Government Receivables

Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

There are no specific rules applicable to receivables contracts where the government or a government agency is one party. It should be noted that the government will be immune in Norway against enforcement proceedings. This immunity against enforcement actions may extend also to certain government agencies depending on the legal basis for, and the tasks of, the actual governmental agency in question.

### 2 Choice of Law – Receivables Contracts

#### 2.1 No Law Specified

If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Norway that will determine the governing law of the contract?

If no express choice of law has been made in the contract between the seller and the obligor the Norwegian international private law principle says that the governing law of the contract will be the law in the country with the closest connection to the matter. Factors that will be relevant when determining which law has the closest connection to the matter will be (i) location of the seller and the obligor, (ii) where the order is received, (iii) where payments shall be made, etc. This principle may lead to the law of the contract being at the place of the debtor/obligor if payment shall be made at the place of the debtor.

The Act on Private International Law Applicable to the Purchase of Movable Assets will apply to the purchase of movable assets that have a connection to more than one country. If the parties have not specified a choice of law the actual purchase will be subject to the laws of the country where the seller was located when the order was
received. If the seller received the order in the buyer’s country, then the law of the buyer’s country will apply.

2.2 Base Case. If the seller and the obligor are both resident in Norway, and the transactions giving rise to the receivables and the payment of the receivables take place in Norway, and the seller and the obligor choose the law of Norway to govern the receivables contract, is there any reason why a court in Norway would not give effect to their choice of law?

No, the choice of Norwegian law would be upheld by the Norwegian courts.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Norway but the obligor is not, or if the obligor is resident in Norway but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Norway give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Yes, a court in Norway would give effect to the choice of foreign law made by the parties provided the chosen foreign law does not contravene Norwegian public policy or Norwegian mandatory laws.


Yes, the United Nations Convention on the International Sale of Goods has been implemented into the Norwegian Purchase of Goods Act by so-called “transformation”. This follows from the Norwegian Purchase of Goods Act, see section 5, and chapter XV with specific rules applicable to international purchases. The provisions in the United Nations Convention on the International Sale of Goods (as implemented in Norway) does not apply to Nordic purchases (where the seller and buyer are located in any of: Norway; Sweden; Denmark; Finland; or Iceland), and the positions has been reserved with regard to the rules relevant to the formation of a purchase contract. The provisions of the Conventions have been transformed into the Norwegian Act.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Norwegian law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Norwegian laws or foreign laws)?

No, the parties to a contract for the sale of receivables are generally free to choose which law shall govern the sales contract. (In other words, same freedom to choose governing law as between the seller and the obligor.)

3.2 Example 1: If (a) the seller and the obligor are located in Norway, (b) the receivable is governed by the law of Norway, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Norway to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Norway, will a court in Norway recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, the sale will be recognised as effective against the creditors or insolvency administrators of the seller or the obligor, provided the sale of the receivables has been properly perfected under Norwegian law. For the sale to be perfected under Norwegian law the obligor must receive notice about the sale of the receivables from the seller to the buyer.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Norway, will a court in Norway recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

If the sale of the receivables is subject to Norwegian law but the obligor and/or the purchaser are located outside Norway, the sale will, if perfected in accordance with Norwegian law (by notice to the obligor), be effective against the seller’s creditors or insolvency administrator. There is a risk that the Norwegian court may require that the foreign law perfection requirements for the sale of the receivables at the location of the obligor must be taken into account as well. Hence it is advisable to ensure that the perfection requirements that apply to the sale of receivables in the country of the seller and also in the country of the obligor are complied with. This is because there is no clear conflict of law rule in Norwegian private international law relevant to the sale of receivables.

3.4 Example 3: If (a) the seller is located in Norway but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Norway recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Norway’s own sale requirements?

On the basis that the parties are free to choose the law to govern the sale of the receivables, and it is clear that the sale has been properly perfected under the laws of the obligor’s country, we believe that it will be difficult for the creditors of the seller to contest the sale on the basis that Norwegian law perfection requirements have not been complied with. However we would advise that Norwegian law perfection requirements for the sale also be complied with to ensure that no doubt can be raised about the sale and to ensure that the sale is effective against the seller’s creditors or insolvency administrator.
3.5 Example 4: If (a) the obligor is located in Norway but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Norway recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Norway’s own sale requirements?

We would advise that Norwegian law perfection requirements relevant to the sale of the receivable should be complied with in addition to the rules that apply in the country of the seller to avoid that the creditors or insolvency administrators of the obligor in Norway contest the sale, and to ensure that the obligor pays the purchaser.

3.6 Example 5: If (a) the seller is located in Norway (irrespective of the obligor’s location), (b) the receivable is governed by the law of Norway, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Norway recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Norway and any third party creditor or insolvency administrator of any such obligor)?

For the sale to be effective against the creditors or an insolvency administrator of the seller or obligor located in Norway the sale of the receivables should, even if the foreign law of the foreign purchaser is chosen for the receivables sale contract, be perfected in accordance with Norwegian law.

4 Asset Sales

4.1 Sale Methods Generally. In Norway what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The customary terminology will be either a sale, transfer or a purchase of receivables. The term assignment of receivables would normally suggest a security arrangement rather than a sale/purchase.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Notice to the obligor is the perfection requirement for the sale of receivables. There are no requirements to the form of notice, who shall send/give the notice (seller or buyer) or that the notice is in writing (although verbal notice is not recommended).

In addition, it is recommended that the seller is deprived of control over the receivable and the income/payment of the receivable due to the fact that where the seller retains control over the receivable and the income, the arrangement risks being re-characterised as an assignment for security purposes rather than a sale.

Once notice has been received by the obligor, the notice will be effective also against subsequent good faith purchasers of the receivables.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The sale of promissory notes can be noted on the promissory note itself as transferred to a new creditor. In addition the promissory notes should be taken out of the seller’s possession and kept by the buyer or a third party holding the promissory note on behalf of the buyer and thus perfected.

Mortgage loans will normally relate to real property or assets that are subject to registration in a public registry such as ships or vehicles, etc.; the additional perfection requirement, in addition to the transfer endorsed on the actual mortgage document would be the registration of the sale and the new creditor in the relevant registry, i.e. the Land Registry or the Ship Registry or other relevant registry.

It follows from the Norwegian Financial Contract Act Chapter 3 section 55 that consumer loans must be in writing but cannot take the form of a negotiable document. The perfection requirement for the sale of a consumer loan is also notice to the consumer obligor. If the credit has been given by a finance institution the loan can only be sold to another finance institution (or similar) unless the consumer obligor has given the consent to the transfer to another creditor.

 Marketable debt securities will be dematerialised in Norway meaning that no document will be issued in evidence of the debt, but the debt will be registered in the Norwegian paperless securities register, “VPS”. Sale of dematerialised securities obtains perfection by registration in the VPS System.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Notice to the obligor that the receivable has been sold is a perfection requirement and must be given by either the seller, or purchaser, or both.

Consent from the obligor is not a perfection requirement (unless the actual receivable contract contains an express transfer prohibition or state that the consent from the debtor is required for a transfer to be valid). An acknowledgement of the notice of transfer from the obligor is not a perfection requirement under Norwegian law, but is in practice used as that will constitute the required evidence that the notice has reached the obligor. If no acknowledgement is provided for, the seller or buyer who give notice must ensure by other means that the notice is received at the address of the obligor by, for example, sending the notice by recorded mail.
(a) If the receivables contract is silent on the issue of assignment/sale, the rule is that the receivable can be assigned without specific consent from the obligor. The rule is based on the general principle that money claims are transferable unless specifically prohibited.

(b) If the receivables contract expressly prohibits assignment, a sale in violation of the prohibition means the seller risks liability for breach of contract to the obligor and that the transfer to the buyer will not be valid as against the obligor.

There are benefits in giving notice; once the obligor has been notified about the transfer the obligor can no longer pay the seller but must pay the buyer (or any other entity that follows from the notice itself). The obligor can only set off counterclaims against the purchaser if the obligor has acquired the counterclaim prior to the receipt of the notice of the transfer and the counterclaim falls due for payment prior to the receivable that is subject to the transfer.

The purchaser of the receivable will not gain any better position than the seller had with regard to the receivable that has been purchased, and hence the obligor can net or set off related counterclaims arising out of the transferred receivable.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective? Is a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

As already mentioned herein, there are no requirements to the form of notice or to the service of the notice other than it must be ensured that the notice is received at the place of business of the obligor and so that the obligor has the chance of being informed about the content of the notice. The burden of proof rests with the sender of the notice, hence the comment above that the notice should be sent by recorded mail if the obligor shall not acknowledge receipt of the notice.

The notice must specify the receivable that has been sold and the legal relationship that the receivable stems from.

Notice can be given at any time but not after the insolvency of the seller and the receivable from that time, will be seen as part of the seller’s insolvency estate.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Norway? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Norway recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Yes, restrictions in receivables contracts prohibiting sale or assignment are enforceable and should be adhered to by the parties. It follows from the Norwegian Financial Contracts Act section 45 that a finance institution, a municipality or a county municipality (both local authorities) can transfer a loan to another finance institution without specific consent from the obligor.

If a contractual sales prohibition is breached, the seller will be liable for breach of contract to the obligor and the sale will not be effective for the purchaser as no valid contract will exist between the obligor and the purchaser.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

There is no specific identification requirements other than that the obligor must understand which receivable has been sold. The specification must be sufficient to allow for proper notice of the sale to the relevant obligors to ensure that the sale becomes effective.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

If the parties denominate the transaction as a sale and state that their intention is a sale, a Norwegian court would - if invoked - be able to look into the economic characteristics of the transaction. (It should be noted, however, that we are not aware of any court decisions on the re-characterisation issue). A sale of receivables risks being re-characterised as a security assignment, i.e. a secured loan rather than an outright sale depending on what has been agreed between the seller and the buyer with regard to the transfer of credit risk on the obligor, interest rate risk and the control over the collection of the income from the receivables.

If the seller retains:

(a) the credit risk that may suggest that in fact the arrangement is a factoring arrangement where there is going to be a subsequent settlement between the seller and buyer later, i.e. the credit risk on the obligor risk has not been transferred to the buyer, likewise if the buyer is not given the right to freely dispose over the receivables that have been transferred;

(b) the interest rate risk, that may also be an argument in favour of a loan and in particular if coupled with the seller having the credit risk and also control over the claims collection; and

(c) control of collections; if the seller shall collect the claims and the buyer has no control over the collection or the collection account, that may be used as an argument to state that the arrangement is a secured loan rather than an outright sale.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, the seller and buyer can agree to sell and transfer existing and future claims on a named obligor arising out of a specific legal relationship (typically a trade account). Prior to the seller’s insolvency this raises no issues. If the seller becomes the subject of
insolvency proceedings the insolvency administrator will have to
decide whether or not to continue the contract.

4.10 Future Receivables. Can the seller commit in an
enforceable manner to sell receivables to the purchaser
that come into existence after the date of the receivables
purchase agreement (e.g., “future flow” securitisation)? If
so, how must the sale of future receivables be structured
to be valid and enforceable? Is there a distinction
between future receivables that arise prior to or after the
seller’s insolvency?

Yes, the sale of future receivables will be treated as the continuous
sale of receivables.

In Norwegian law it is possible for a registered business (registered
in Norway) to agree to sell, assign for security purposes, or pledge
its existing or future claims that arise in the business as a result of
the sale of goods or services (trade receivables as opposed to, for
instance, tax refunds), or to sell, assign for security purposes or
pledge only a part of the trade receivables. In such sales it is not
required to disclose the name of the obligor and no notice to the
obligors are required. The sale, assignment for security purposes or
pledge will obtain perfection by registration of a factoring
agreement as a charge on the seller in the Norwegian Movable
Asset Registry (Løsøreregisteret). However, the registration of the
sale/assignment or pledge will not protect the buyer against another
buyer who has acquired in good faith a competing right to a
receivable included in the registered sale/assignment or pledge, and
who has obtained perfection based on notice given to the obligor.

A registration of a factoring arrangement will be protected against
the seller’s creditors or insolvency administrators and receivables
that did not exist at the insolvency of the seller, but have been
transferred and registered and will not form part of the insolvency
estate (as these will be paid directly to the buyer).

The use of factoring agreements and registration in the Movable
Assets Registry as a perfection requirement will only work in a
securitisation transaction where the receivables that are sold include
all or a distinct/separate part of the seller’s trade receivables.

If future claims are sold and perfected by way of notice to the
obligor, such claims will not form part of the insolvency
estate (as these will be paid directly to the buyer).

We refer to the answer given in question 5.1 above. The perfection
requirement for the purchaser’s posting of a security interest over the receivables that the purchaser has bought will be
notice to the obligors that the receivables have been posted as
security to the financing bank of the purchaser.

Please note that Norwegian law contains a prohibition on the
creation of one general charge to encompass all the present and
future assets of the security provider. The purchaser must therefore,
under Norwegian law, charge each and every asset that may be
subject to a charge under Norwegian law separately. (Norwegian
law provides for floating charges to be granted over trade
receivables, see above under question 4.10, operational equipment
used in the business, business vehicles and inventory.) The
perfection requirements for each and every asset charged must be
complied with for the charge to be validly perfected under
Norwegian law.

If related security is to be transferred concurrently with the sale of
receivables (for instance, insurance or guarantees), the transfer of
the related security must be perfected as well by notice to the
insurance company, guarantor, etc.

4.11 Related Security. Must any additional formalities be
fulfilled in order for the related security to be transferred
concurrently with the sale of receivables? If not all
related security can be enforceably transferred, what
methods are customarily adopted to provide the
purchaser the benefits of such related security?

The perfection requirement for the purchaser’s posting of a security interest over the receivables that the purchaser has bought will be
notice to the obligors that the receivables have been posted as
security to the financing bank of the purchaser.

5 Security Issues

5.1 Back-up Security. Is it customary in Norway to take a
“back-up” security interest over the seller’s ownership
interest in the receivables and the related security, in the
event that the sale is deemed by a court not to have been
perfected?

In Norwegian law the perfection requirement for a sale of a
receivable is notice to the obligor. The perfection requirement for
a security assignment or a pledge of a receivable is also notice to the
debtor. It is not common to take “back-up” security over the seller’s
ownership interest in the receivables and related security in addition
to a sale and to secure the sale should the sale be deemed by a court
not to have been perfected.

5.2 Seller Security. If so, what are the formalities for the
seller granting a security interest in receivables and
related security under the laws of Norway, and for such
security interest to be perfected?

The perfection requirement for the purchaser’s posting of a security interest over the receivables that the purchaser has bought will be
notice to the obligors that the receivables have been posted as
security to the financing bank of the purchaser.

Please note that Norwegian law contains a prohibition on the
creation of one general charge to encompass all the present and
future assets of the security provider. The purchaser must therefore,
under Norwegian law, charge each and every asset that may be
subject to a charge under Norwegian law separately. (Norwegian
law provides for floating charges to be granted over trade
receivables, see above under question 4.10, operational equipment
used in the business, business vehicles and inventory.) The
perfection requirements for each and every asset charged must be
complied with for the charge to be validly perfected under
Norwegian law.

5.3 Purchaser Security. If the purchaser grants security over
all of its assets (including purchased receivables) in
favour of the providers of its funding, what formalities
must the purchaser comply with in Norway to grant and
perfect a security interest in purchased receivables
governed by the laws of Norway and the related security?

5.4 Recognition. If the purchaser grants a security interest in
receivables governed by the laws of Norway, and that
security interest is valid and perfected under the laws of
the purchaser’s country, will it be treated as valid and
perfected in Norway or must additional steps be taken in
Norway?
perfection requirements should be followed in addition to the perfection requirements of the purchaser’s country.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

To create security over an insurance policy, the seller/pledgor and purchaser/pledgee need to enter into a pledge agreement or a declaration of pledge and notice of the charge must be given to the insurer/obligor under the insurance policy.

For negotiable promissory notes, the parties need to enter into a pledge agreement covering the promissory note and the promissory note itself must be taken out of the possession of the seller/pledgor, i.e. the purchaser/pledgee takes possession or anyone holding it on behalf of the pledgee.

Security in marketable debts securities are created by a pledge agreement and registration of the security interest created in the VPS System.

5.6 Trusts. Does Norway recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Norwegian law does not contain the English law concept of trust. Agency is a recognised concept in Norwegian law and the agency contract will have to say clearly the duties/authority of the agent. If the seller shall collect receivables on behalf of the purchaser it should, as a minimum, be ascertained that the collected receivables are held on a separate collection account.

5.7 Bank Accounts. Does Norway recognise escrow accounts? Can security be taken over a bank account located in Norway? If so, what is the typical method? Would courts in Norway recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Norway?

Yes, escrow accounts are accounts where two parties have agreed to the terms of the operation of the account and notified the bank holding the account accordingly.

Yes, security may be taken over a bank account located in Norway. The security will be perfected by giving notice of the security to the bank holding the account. It is possible to pledge bank accounts so that the seller/pledgor is given the right to use funds from the account for operational purposes, i.e., it is not required that the account is blocked.

Norwegian court will require that the proper perfection requirements under Norwegian law are complied with for the creation of valid pledge of the bank account here. Hence if the perfection requirements under an English law are different from those under Norwegian law, the Norwegian law requirement must be followed as well.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Yes, within any limitations that follow from the set off rights that the bank may have against the account holder. (For example, it follows from the Financial Contract Section 29 that the bank cannot set off any amounts in the account except for claims due to the bank which arise out of the account agreement with the owner of the account.)

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, see the answer to question 5.7.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Norwegian insolvency laws automatically prohibit the purchaser from collecting, transferring or exercising ownership rights over the purchased receivables (“a stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the sale has been perfected, the receivables will not belong to the seller and the purchaser can continue to collect the receivables as before.

If the purchaser is a secured party and the security has been properly perfected the purchaser can enforce the rights of secured creditor and continue to collect the claims on that basis.

There is no automatic stay of action that extends to the actions of the purchaser, only to the actions of the seller who is subject to the insolvency proceedings and to the seller’s assets. A dispute may, of course, be raised as to whether a sale or a security is effective but this is for the insolvency administrator to raise as an issue or other creditors and objections can of course lead to claims for revocation of transactions undertaken prior to the insolvency.

(For security rights that can only be enforced through the enforcement authorities the situation is that the insolvency proceedings imposes a stay of action and so that the security holder, cannot enforce the security in the stay period which is six months (see the Norwegian Insolvency Act section 17).)

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the Insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

See above under question 6.1, the insolvency administrator (with the consent of the majority of the creditors) can use means available through the courts - for instance temporary injunctions to freeze the position until the legal issues are solved through the courts.
6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Norway for (a) transactions between unrelated parties and (b) transactions between related parties?

A duly perfected transaction or security can be reversed if: the transaction in an improper way benefits one creditor at the detriment of other creditors; or serves to remove the debtor’s assets from serving the creditors; or increases the debt of the debtor if the financial position of the debtor is weak or was seriously weakened by the transaction and the other party to the transaction knew or should have known about the debtor’s financial difficulties and the circumstances that renders the transaction improper. The claw back period for this subjective rule is 10 years and so that transactions perfected more than 10 years before the opening of the insolvency cannot be revoked by virtue of this provision.

In addition there are the objective claw back rules:

(i) gifts completed later than a year before the opening of the insolvency can be revoked;

(ii) extraordinary payments made by the debtor later than three months before the opening of the insolvency can be revoked if the payment is unusual and substantially results in a weakening of the debtor’s financial position; and

(iii) security for old debt, i.e. security posted by the insolvent debtor later than three months before the opening of the insolvency proceedings if the security is for old debt (debt in existence before the creation of the security or if the perfection measure is not organised without delay after having incurring the debt).

This three-month period is extended to two years between related parties.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

In general, it is not possible for the insolvency official to consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates. It cannot be out-ruled that a judge could look differently at the corporate structures where the companies and the management of the companies are interconnected, or if the corporate structures have been established to benefit only certain creditors or parties.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Norway, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

The insolvency administrator shall assess the assets and the liabilities of the bankruptcy debtor. The insolvency administrator has to decide how to handle the bankruptcy debtor’s contractual obligations; such as the continued sale of receivables that occur (or receivables that have been sold and only come into existence after the opening up of the insolvency proceedings. The insolvency administrator can choose whether to terminate or to continue the contract. If the insolvency administrator decides to continue the contract, the contract will continue on its terms.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Norway establishing a legal framework for securitisation transactions? If so, what are the basics?

Yes. The Norwegian Financing Activity Act has since January 2004 had a chapter V headed “Securitisation of loan portfolios” which enables finance institutions to transfer a fixed loan portfolio or other group of claims to a special-purpose vehicle for securitisation. The SPV will be exempt from the licensing requirements for banks.

The finance institution must, before the transfer, inform the loan obligors affected by the transfer about the entity that shall manage the loan after the transfer and of which rights and obligations the special purpose vehicle and the finance institution shall have towards the loan obligors. The loan obligors will have at least three weeks to object and if the obligor does not object that will be construed as consent in accordance with Financial Contract Act section 45. (This consent right cannot be waived by contract in consumer loans.)

7.2 Securitisation Entities. Does Norway have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Yes. The SPV cannot conduct any other business than to acquire, own and collect on the loan portfolio. The SPV must finance the acquisition of the loans by the issue of bonds. The SPV must be organised as a company limited by shares (private or public) although permission can be obtained for another corporate form (for instance an Irish limited company). The SPV cannot use the same name as the finance institution that has sold the loans and the SPV can only contract with the transferring finance institution for the management of the portfolio, or a bank or another finance institution similar to the transferor institution.

7.3 Non-Recourse Clause. Will a court in Norway give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Yes, in general the courts in Norway would give effect to such a contractual provision unless it is deemed unreasonable.

7.4 Non-Petition Clause. Will a court in Norway give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

At the outset the contractual provisions will be respected unless the provision is deemed unreasonable.
8.3 Data Protection. Does Norway have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Norwegian Data Protection Act applies to the possession and dissemination of personal data related to individuals and to some extent, to companies. Personal data may only be gathered for certain specific purposes and must be processed in accordance with the Data Protection Act.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Norway? Briefly, what is required?

The Norwegian Financial Contract Act contains a number of provisions that must be observed with regard to consumer loans and which cannot be deviated from. The rules apply to credit agreements (any form of postponement of payment, or loan). There are rules on notice and to a certain extend consent from the obligor in case the loan is transferred, information duties when marketing the credit, information duties at the entry into a credit agreement, the lenders’ duty to consider the creditworthiness of the consumer, duty to explain the credit, and duty to advise the consumer not to take up the credit, form and content of the credit agreement, change of conditions, interest on delayed payment, termination, the consumer’s right to terminate or void the agreement within the first 14 days, mandatory pre-payment, set off right, etc.

No, it does not.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Norway? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments on receivables by obligors to the purchaser or the seller are not subject to Norwegian withholding taxes provided that the purchaser/seller does not have a permanent establishment in Norway with regard to the sale of the receivables, and that the “debt” is not considered as “equity” for Norwegian tax purposes in accordance with thin capitalisation rules.

9.2 Seller Tax Accounting. Does Norway require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

As a main rule, no specific accounting policy is required for tax purposes in the context of a securitisation. Please note that losses on loans and guarantees which are deducted as an expense in the financial statements in accordance with Norwegian accounting rules should be tax deductible.
9.3 Stamp Duty, etc. Does Norway impose stamp duty or other documentary taxes on sales of receivables?

There is no stamp duty or other documentary taxes on the sale of receivables.

9.4 Value Added Taxes. Does Norway impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

As a general rule, sale of goods and rendering of services in Norway is subject to Norwegian Value Added Tax (VAT) at an ordinary rate of 25 per cent.

The sale/transfer of receivables is exempt from VAT in Norway.

Collection agent services are subject to VAT in Norway.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Payment of VAT and taxes when applicable is the responsibility of the seller. Claims for unpaid direct and indirect taxes cannot be made against the purchaser of the receivables.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Norway, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Norway?

The purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors will not make the purchaser liable to tax in Norway provided that the purchaser does not have a permanent establishment in Norway. If the collection agent, etc., act in its ordinary course of business, has other clients, and no authority to conclude contracts in the name of the purchaser, the purchaser should not be deemed to have a permanent establishment in Norway.

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Thommessen is one of Norway’s leading commercial law firms with offices in Oslo, Bergen and London. The firm has 300 highly qualified employees: 200 lawyers covering the entire area of business law. With more than 150 years in business, Thommessen has consistently acted in the largest and most complex matters seen in Norway and contributed to shaping the legal landscape. Bringing experience and innovation together, the firm is well placed to meet the clients’ need of timely and bold advice. Thommessen is an independent law firm and has established relations with highly regarded law firms all over the world. This enables the firm to choose the law firm best suited to handle its clients’ cases at all times. Thommessen places great emphasis on being a professional partner for its clients and on providing independent advice of the highest professional and ethical standard. They have adopted their own code of conduct and strive to be a market leader also in terms of ethical standards.
Chapter 30

Panama

Patton, Moreno & Asvat

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of behaviour of the parties?

a) Commercial contracts in general are not subject to special formalities for their validity. Whichever is the form and language of the contract, the parties shall be obligated in the manner and terms agreed upon between them. Good faith and the parties’ real intent prevail with respect to the letter of the agreement. Except for documents technologically filed, pursuant to article 1102 of the Civil Code, any commercial obligations exceeding US$ 5,000 must be in writing and thus it is convenient to have the sale of goods or services evidenced in a written contract.

b) Invoices accepted by the obligor are one of the means of evidence of a commercial obligation (article 244 of the Code of Commerce) which rank below public documents, private documents and merchant’s minutes.

c) In the absence of a formal written agreement, a receivables contract may be deemed to exist as a result of historic relationships, if sufficient evidence is presented based on the general provisions of the Code of Commerce.

1.2 Consumer Protections. Do Panama’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

a) Interest rates by banks and other financial entities are not regulated and there is no maximum legal rate. Maximum rates of interest on consumer credit, loans or other receivables applied by market agents to the general consumers may be determined by the Consumer Protection and Competition Authority, but to date such maximum rate has not been established. By means of Law No.81 of 31 December 2009 the rights of credit card holders are regulated, but no limits are imposed on rates of interest that may be charged by the credit card issuers. Law No.81 provides that the nominal interest rate may not be modified without a prior notice given at least 30 calendar days in advance. The first increase cannot take place before the first year of the contract elapses.

b) The commercial statutory right that applies to interest on late payments is 10 per cent per annum (article 223 of the Code of Commerce) in the absence of a contractually-agreed interest rate in the specific contract.

c) Consumer protection provisions prohibit the execution of blank documents by consumers and obligate providers to expressly state the interest rate effectively paid which may not exceed the maximum legal rate.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

As a general rule, all administrative contracts must be in writing and countersigned by the Comptroller General of the Republic and published in the Official Gazette for their validity and perfection. In addition, express authorisation by the Cabinet of Ministers and the favourable opinion of the National Economic Council may be required for governmental obligations that exceed US$ 2,000,000. Pursuant to Law Decree No.7 of 2 July 1997, the issuance of bonds, promissory notes or any other State securities requires prior approval of the National Economic Council. Negotiability of government instruments is not restricted. On the other hand, credits against the Government are regulated by certain provisions of the Tax Code and are deemed to be preferred credits with respect to other credits, except for credits on real property rights, salaries and indemnifications owed to workers, quotas owed to the Social Security Entity, to name a few. Under article 1072-A of the Tax Code, credits against the government accrue an interest rate (per each month or fraction) of two (2) percentage points over the market reference rate annually listed by the Superintendence of Banks. The reference rate of the market shall be fixed in attention to the rate charged by commercial banks during the preceding six (6) months in commercial banking financings.

Under our securities law (article 346 of Law Decree No.1 of 1999), the State and any autonomous, semi-autonomous and mixed capital entities may issue and place securities at a discount of their nominal value. These securities may also be repossessed pursuant to the procedure set forth in the Judicial Code, but the State and any State-owned entity shall not be obligated to replace securities that were initially issued to bearer. These entities may also issue certificated or uncertificated securities which may be deposited in clearing houses.
2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Panama that will determine the governing law of the contract?

Pursuant to the applicable international private law provisions of Law 15 of 1928 (also known as the Bustamante Code), the situation of any credit is determined by the place in which it will be enforced and if not expressly stated, at the obligor’s domicile. If judicial enforcement is to be sought in Panama, there are specific provisions in the Judicial Code that govern the attribution of jurisdiction, such as: the domicile of the legal entity that is sued, and the place of enforcement of the obligation, among other rules.

2.2 Base Case. If the seller and the obligor are both resident in Panama, and the transactions giving rise to the receivables and the payment of the receivables take place in Panama, and the seller and the obligor choose the laws of Panama to govern the receivables contract, is there any reason why a court in Panama would not give effect to their choice of law?

No. The only exception would be the parties agreeing to settle the dispute by arbitration, in which case the court must decline competition in favour of the arbitration court.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Panama but the obligor is not, or if the obligor is resident in Panama but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Panama give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such that between the seller and the obligor under the receivables contract?

Yes, the principle of freedom of contracting governs contractual obligations between the parties. Therefore, it is possible for a Panamanian counterparty to submit to the laws of another country or jurisdiction provided that such foreign law does not violate domestic public policy (choice of law). In addition, the parties may also submit to the courts or tribunals of a jurisdiction different to that of the Republic of Panama (choice of jurisdiction).

2.4 CIGS. Is the United Nations Convention on the International Sale of Goods In effect in Panama?

No, Panama is not a party to this Convention.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Do Panama’s laws generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Panama’s laws or foreign laws)?

Under Panamanian law, the sale of receivables and the receivables themselves may be governed by a foreign law, according to the principle of freedom of contracting. Nonetheless, enforcement in Panama would require certain formalities to be observed pursuant to Panamanian law, such as notice to the obligor of an assignment of the receivables duly acknowledged by notary public or any other authentic manner.

3.2 Example 1: If (a) the seller and the obligor are located in Panama, (b) the receivable is governed by the law of Panama, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Panama to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Panama, will a court in Panama recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes. If the sale of the receivable complies with the requirements of Panamanian law, a Panamanian court would recognise the sale as being effective against the parties involved in the sale. The foreign purchaser would have to seek enforcement of the receivable in Panama. Any creditors of the obligor or the seller or any insolvency administrators of the seller and the obligor pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivable.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Panama, will a court in Panama recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

If the obligor of the receivable is not located in Panama, the foreign law requirements of the obligor’s country must be taken into account. In the event there is enforcement in Panama, a Panamanian court would enforce these foreign law requirements to the extent they do not contravene public policy provisions governing the sale of the receivables.

3.4 Example 3: If (a) the seller is located in Panama but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Panama recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Panama own sale requirements?

If the obligor of the receivable is not located in Panama, the foreign law requirements of the obligor’s country will apply to the sale. In the event there is enforcement in Panama, a Panamanian court would enforce these foreign law requirements to the extent they do not contravene public policy provisions governing the sale of the receivables. Any creditors of the obligor or the seller or any insolvency administrators of the seller and the obligor pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivables.
3.5 Example 4: If (a) the obligor is located in Panama but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Panama recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Panama own sale requirements?

If the obligor of the receivable is located in Panama, it may agree to be subject to a foreign law. In the event there is enforcement in Panama, a Panamanian court would enforce the sale against the obligor to the extent these foreign law requirements do not contravene Panamanian public policy provisions. Any creditors of the obligor or the seller or any insolvency administrators of the seller and the obligor pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivables.

3.6 Example 5: If (a) the seller is located in Panama (irrespective of the obligor’s location), (b) the receivable is governed by the law of Panama, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Panama recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Panama and any third party creditor or insolvency administrator of any such obligor)?

The parties may agree that the purchase of the receivables be subject to a foreign law. In the event there is enforcement in Panama, a Panamanian court would enforce the sale to the extent these foreign law requirements do not contravene Panamanian public policy provisions. Any creditors of the seller or any insolvency administrators of the seller pursuant to a bankruptcy filing made in Panama are subject to the priority stated for the respective credit under the receivables.

4 Asset Sales

4.1 Sale Methods Generally. In Panama what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment of something else?

Under applicable Commerce Code provisions, any commercial document or title whereby its issuer recognises an obligation to pay a determined amount of money or a certain amount of fungible things, at a determined place and date, may be assigned by endorsement, if it was issued to the order of the issuer. If issued nominative or non-endorisable, general civil law provisions regarding assignment of credits would become applicable.

Unless otherwise provided, the assignor of a commercial receivable is only responsible for the legitimacy of the credit and the legal capacity under which the assignment was executed.

It is customary to structure it as an assignment of credits.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Regular endorsement of a receivable made in good faith will convey to the assignee all rights incorporated in the document.

Regarding titles that are not issued to the bearer or endorsable, an assignment will be legally effective from the date it is notified to the obligor before two witnesses or by any other means that provides for authenticity. Should the obligor refuse to acknowledge an assignee as a new creditor and wish to oppose exceptions not resulting from the assigned receivable; it must raise action against it within the next 24 hours, a term after which the assignment will be validly executed.

Assignment of a receivable issued to a bearer is validly executed by delivery of the document and the holder of such receivable is entitled to sufficient title to claim incorporated rights.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Mortgage loans may be assigned but applicable legal provisions require registration at the Public Registry. Assignment would only be deemed to be validly executed from the registration date. Local entities have successfully carried out securitisation of mortgage loans, thus complying with the requirement of registration.

Consumer loans and promissory notes may typically include contractual clauses expressly permitting assignment of credit and would, in practice, be assigned by means of a written agreement between the assignor and the assignee.

 Marketable debt securities admitted for public trading would be transferred in the books of issuers through the facilities of the clearing and settlement entity acting as such in the relevant organised market. Transfer of publicly-traded securities is also regulated by Decree Law 1 of 1999 (the Securities Law).

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Are there any limitations regarding the purchaser notifying the obligor of the sale of receivables even after the insolvency of the seller or the obligor?

Applicable Code of Commerce provisions state that with regard to titles that are not issued to the bearer (registered form) or endorsable, an assignment will be legally effective from the date it is notified to the obligor before two witnesses or by any other means that provides for authenticity as to the date that it is made. This means that it has to be made known to the obligor but it is not necessary to obtain his consent to perfect the transaction. Should the obligor refuse to acknowledge the assignee as the new creditor and should be wish to oppose exceptions not resulting from the assigned receivable; the obligor must bring action against the assignee within the next 24 hours, a term after which the assignment will be validly executed.
4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

General commercial law only imposes the obligation to notify the assigned obligor of the assignment at the time of execution or shortly thereafter. There is no requirement for approval or consent of the obligor. It is required that the assignment is made known to the obligor by any authentic means at a certain date. The obligor, that before being notified of the assignment, satisfies the creditor will be released from the obligation. Should the obligor refuse to acknowledge the assignee as the new creditor and wish to oppose exceptions not resulting from the assigned receivable the obligor must bring action against the assignee within the next 24 hours, a term after which the assignment will be validly executed. The notice can apply only to specific receivables or to any, and all (including future), receivables. After insolvency proceedings against the obligor or the seller have commenced, the notice cannot be delivered since all commercial obligations are terminated from the bankruptcy declaration.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Panama? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Panama recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

General commercial law only imposes the obligation to notify the assigned obligor of the assignment, not to obtain his approval or consent. Therefore, it is required that the assignment is made known to the obligor by any authentic means at a certain date. The obligor that before being notified of the assignment satisfies the creditor, will be released from the obligation. Applicable legal provisions determine that liability could arise, on the part of the seller, if it were to assign a receivable that expressly prohibited such a transaction. No particular legal provisions exist on the matter; therefore only general civil liability could apply upon legal action taken by the obligor.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The receivables subject to the assignment must be identified, subject to general provisions of the Civil and Commerce Codes. There are no legal specifications as to the information that would be required in the assignment contract, but in practice it would at least contain the following information: debtor’s name; debtor’s ID number; document’s number; date; and outstanding balance. There is no legal requirement that the receivables being sold share certain objective characteristics. In local practice, securitisation schemes operate with blocks of receivables sharing homogeneous profiles. If the seller sells all of its receivables to the purchaser, or if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, the same comments apply.

Assignment of a receivable includes all accessory rights, such as mortgages, liens and other privileges. A seller in good faith will be liable for the existence and legitimacy of the credit at the time of sale, unless it was sold as dubious, but not of the debtor’s solvency, unless it was expressly agreed otherwise, or that the insolvency was pre-existent and public. Even in these cases, the seller will only be liable for the price received, additionally reimbursing the purchaser of the expenses associated with the execution of the contract and expenses generated by the asset that was sold. A seller not acting in good faith will always be liable for payment of all expenses, plus damages caused.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Panamanian Securities Law provides that receivables and other future rights or intangibles may be assigned for the purpose of being securitised. Said credits may be assigned even prior to the date from which the contracts are to be entered into, the securities or titles represented thereby will emerge or be granted. Future credits which are the object of the transfer must be identified or ascertainable in the transfer contract. In order to be ascertainable it will suffice that they be identified in the future by means of parameters, formulas, descriptions or other proceedings established in the assignment contract, even though they are not individualised in the latter. A contract of assignment of future receivables shall be in writing and will be enforceable against third parties from the date the transferors set their signature thereunto, or from the date it is acknowledged before a Notary, or as from its protocolisation in a public deed. It may include repurchase or redemption provisions. The authentication of the signatures before a Notary or the protocolisation of the transfer contract of the futures credits shall be equivalent to the delivery of the res, if the contrary could not be clearly ascertained from said contract. The transfer of futures credits shall be enforceable against the obligor of the credit transferred when served by written notice by whatever means. The transfer of futures credits is enforceable against the bankruptcy of the assignor from the date on which the contract is enforceable against third parties, but subject to other general provisions regarding bankruptcy.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The seller can agree to continuous sales of receivables prior to
insolvency, but the effects of the bankruptcy declaration will apply to such agreement as to any other contractual obligation that will be terminated as of such date.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? In that regard, is there a distinction between receivables that arise prior to or after the seller’s insolvency?

Yes, in the context of the securities market it is possible; see the answer to question 4.8 above.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

If related security exists over the receivables, each of those would most likely require separate formalities in order to be concurrently transferred with the underlying credit. For instance, an insurance policy over the lives of debtors would require endorsement of the policy with the insurance company, the pledging of other assets would require acknowledgement of assignment, etc.

5 Security Issues

5.1 Back-up Security. Is it customary in Panama to take a "back-up" security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary, but nothing would prevent the parties from entering into such an agreement.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Panama, and for such security interest to be perfected?

There are no specific legal formalities provided for in local legislation. If the seller was to grant some kind of collateral upon sale of receivables, general legal provisions regarding the relevant contract would apply (mortgage, insurance, other liens or charges).

5.3 Purchaser Security. What are the formalities for the purchaser granting a security interest in receivables and related security under the laws of Panama, and for such security interest to be perfected?

There are no specific legal formalities provided for in Panamanian legislation. If the purchaser wants to grant some kind of collateral, general legal provisions regarding the relevant contract would apply (mortgage, insurance, other liens or charges).

5.4 Recognition. If the purchaser grants a security interest in the receivables under the laws of the purchaser’s country or a third country, and that security interest is valid and perfected under the laws of that other country, will it be treated as valid and perfected in Panama or must additional steps be taken in Panama?

If the issue at stake is the enforceability of such security interest, a local court would decline making any interpretation or judgment regarding the validity of a contract construed and governed by foreign legislation.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to promissory notes, mortgage loans, consumer loans or marketable debt securities?

No different or specific provisions or formalities exist, other than general provisions applicable to the perfection of collaterals.

5.6 Trusts. Does Panama recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, trusts are regulated in Panama by means of Law No.1 of 1984. Trusts are widely used since trust companies are supervised and overseen by the Superintendence of Banks. Therefore, a trust structure whereby collections are allocated to the trust and held in property by the trustee for the benefit of the creditor is quite a standard transaction.

5.7 Bank Accounts. Does Panama recognise escrow accounts? Can security be taken over a bank account located in Panama? If so, what is the typical method? Would courts in Panama recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Panama?

Escrow accounts are contracts that are subject to the terms and conditions agreed to by the parties under the freedom of contracting principles. A bank account may be pledged in favour of a creditor. Escrow accounts are also common in the marketplace. Panamanian courts would apply public policy principles with regard to the execution of foreign judgments. In this regard the concept of public policy and what it comprises is subject to the criteria of the court on a case-by-case basis.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

A collateral pledge of cash deposited in a bank account is permitted under Panamanian law. The secured party shall have a lien on the amount guaranteed by the pledge until paid in full, but not necessarily on all cash flowing into the bank account, as it is unlikely that the pledgor will continue to make deposits after knowing the enforcement of the pledge.
5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, the owner can have such access.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Panama’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (automatic stay)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Yes, under article 1564 of the Panamanian Code of Commerce, one of the effects of the bankruptcy declaration against the obligor is that, by operation of law, the obligor is inhibited or separated from the management or disposition of its assets and of any acquired during the proceedings.

The Panamanian Code of Commerce regulates the bankruptcy of companies or natural persons engaged in business activities and its effects, but there are no specific provisions to regulate insolvency. Bankruptcy proceedings under Panamanian law aim at distributing the assets of a business among its creditors due to non-payment of one or more liquid commercial obligations. The estate of the business is bound to pay the credits that stand against it, and all creditors have a part against the common obligor.

A petition requesting the declaration of bankruptcy may be filed before a court by the obligor himself, whenever he fails to pay a commercial obligation within the next two days after the obligation is due. The declaration of bankruptcy may also be requested by any creditor of the obligor. To this effect, a request for bankruptcy must be filed, together with evidence of the credit. Once the bankruptcy request is filed, the court issues an order for: the embargo and deposit of the assets, the books, and other documents of the company; the appointment of a curator for the meeting of creditors; the summons of all interested parties to the proceedings within the next ten days; and the summons of the creditors to a general meeting. The general meeting of creditors gathers together every creditor who may have presented his claim within term, and has the object of establishing the amount and type of each credit. The curator must be a lawyer, and is charged with the management of the assets, including the company’s books, the safekeeping and collection of credits, and the sale of all assets with the approval of either the meeting of creditors or the court.

Once the credits have been evaluated and recognised by every creditor, the obligor may present the meeting of creditors with a payment plan. If the plan is accepted, the curator shall supervise its execution. If the plan is not accepted or the obligor offers no plan, the curator shall proceed to sell the assets. Once the obligor fulfils the terms of the plan of payments or the full amount of outstanding credits is paid for, a request can be filed before the court to declare his discharge in order to put an end to the effects of the bankruptcy.

Once the court declares the bankruptcy, it has the following effects on the obligor, among others:

- The court must order the seizure (embargo) of any assets owned by the obligor.
- The obligor may not manage or dispose of his current assets and those acquired while the state of bankruptcy is in force.
- The credits guaranteed with pledge or mortgage may be enforced in a separate proceedings.
- Unless the credits are guaranteed with pledge or mortgage, as of the bankruptcy declaration, the interests on the bankruptcy estate cease to accrue.
- All civil and commercial debts of the obligor are enforceable as of the bankruptcy declaration with discount of the applicable interests.
- Payments and any other transfer and administration legal transactions undertaken by the obligor after the bankruptcy declaration shall be null and void.
- Any bilateral contracts that have not been totally performed or have been partially performed at the time of the bankruptcy declaration shall be terminated by operation of law. In this case, the other contracting party may only claim liquidate damages as creditor of the bankruptcy estate, except if the credit is guaranteed by a pledge or mortgage.

Finally, the granting of a mortgage or pledge or any other act or provision aimed at ensuring credits previously contracted or to give them preference upon other credits, shall also be null and void in the benefit of the mass of creditors, if such acts were carried out after the existence of a legal condition of bankruptcy under article 1545 of the Code of Commerce or in the 30 previous days.

6.2 Insolvency Official’s Powers. If there is no automatic stay, under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

The bankruptcy’s curator has the following powers and attributions:

- The curator must undertake an inventory of assets of the obligor.
- The curator is entitled to act on behalf of the obligor throughout the proceedings.
- The curator also acts on behalf of the creditors’ meetings in all proceedings against the obligor in bankruptcy.
- The curator manages the assets of the obligor.
- The curator collects and receives all credits and rents and pays the obligor’s expenses.
- The curator undertakes the sale of assets of the obligor.
- The curator reviews the titles of credit presented by the creditors and submits said credits to the Creditors’ Meeting for their acknowledgment.
- The curator promotes the celebration of the Creditors’ General Meeting.
- The curator renders accounts of its management to the Creditors’ General Meeting.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolventy official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Panama for (a) transactions between unrelated parties and (b) transactions between related parties?

In connection with fraudulent conveyance issues, under our Code of Commerce, any payments or other legal acts of transfer of title or
administration carried out by the bankrupt after the bankruptcy has been declared shall be null and void without any special declaration. This also applies to any payments made to the bankrupt after the bankruptcy declaration has been published. In addition, it applies to any gratuitous acts or contracts carried out or entered into by the bankrupt during the four years preceding the bankruptcy declaration or its retroactive effects, in favour of the bankrupt’s spouse, children, parents, brothers/sisters or in-laws.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?**

Only to the extent the assets and liabilities of the seller and its affiliates are deemed to be credits of the obligor’s bankruptcy estate.

**6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Panama, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Since one of the effects of the bankruptcy declaration is that any bilateral contracts that have not been totally performed or have been partially performed at the time of such declaration shall be terminated by operation of the law, the sales of receivables that have not yet occurred or have not yet come into existence or that only come into existence after the commencement of such proceedings would be terminated by operation of the law. In these situations, the other contracting party may only claim and liquidate damages as creditor of the bankruptcy estate, except if the credit is guaranteed by pledge or mortgage.

**7 Special Rules**

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Panama establishing a legal framework for securitisation transactions? If so, what are the basics?**

Panamanian Securities Law entitles the Superintendence of the Securities Market to issue regulations regarding the registration, disclosure and reporting requirements of public issue of securities through securitisation schemes.

Regulations have been issued regarding registration of issuers that publicly offer securities, as well as the disclosure and periodic reporting requirements, but no specific regulation has been issued on the subject of securitisation vehicles. Article 197 of said Law expressly refers to securitisation of receivables, including securitisation of future rights (see the answer to question 4.8 above).

Therefore, a local public issue of securities made through securitisation schemes, has been registered under the regulations issued in general for the registration of securities subject to public offerings.

**7.2 Securitisation Entities. Does Panama have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

No laws have been passed with regard to the creation of entities or financial intermediaries specialised in structuring securitisation vehicles or engaged in the business of securitisation at their account and risk. Those who engage in the business do it under general commercial legal provisions.

**7.3 Non-Recourse Clause. Will a court in Panama give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?**

It is likely that such a limited recourse clause would be considered valid by a court. Should the governing law of the contract subject to judicial dispute be that of another country, it is likely that no action would be possible for the parties before local courts.

**7.4 Non-Petition Clause. Will a court in Panama give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

A non-petition clause would most likely be valid; however, a clause preventing one of the parties (having sufficient cause) from initiating insolvency proceedings against any person whose circumstances fit the relevant legal standards may not be considered valid in a court. Should the governing law of the contract subject to judicial dispute be that of another country, it is likely that no action would be possible for the parties before local courts.

**7.5 Priority of Payments “Waterfall”. Will a court in Panama give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

Yes, such provision would be enforceable as it does not violate Panamanian public policy provisions related to the priority of claims.

**7.6 Independent Director. Will a court in Panama give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an Insolvency proceeding) without the affirmative vote of an independent director?**

In general, Directors of corporations may be limited or subject to specific provisions (typically in the organisational documents or the by-laws) from taking action against the company and such a provision is most likely to be valid before a local court. However, a provision preventing or limiting the Director from initiating insolvency proceedings when the circumstances of the company meet the legal standards for such proceedings, might compromise the Director’s fulfilment of legal duties in that capacity and would most likely be invalid.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Panama, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Panama? Does the answer to the preceding question change if the purchaser does business with other sellers in Panama?

It is our understanding that if the purchaser is not actively engaged in financial activities that are subject to public regulation and/or supervision, such as taking deposits, conducting intermediation in the securities markets or otherwise, the mere activity of acquiring and/or investing in receivables originated by other entities, would not trigger the obligation of obtaining licensing or authorisation from a public authority.

The answer would not vary if the purchaser does business with other sellers in the country.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Enforcement and collection of receivables in Panama by a party not doing business in Panama does not require a licence.

8.3 Data Protection. Does Panama have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Law No. 24 of 2002 regulates the information service of credit history of consumers and it applies to both individual obligors and enterprises.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Panama? Briefly, what is required?

Applicable consumer protection provisions would most likely be relevant at the time of origination of credit. Banking and other lending institutions would be subject to on-going information duties with clients and fulfilment of such information duties will typically rely on the party acting as administrator of the receivables.

8.5 Currency Restrictions. Does Panama have laws restricting the exchange of Panama’s currency for other currencies or the making of payments in Panama’s currency to persons outside the country?

At present, there are no laws or regulations restricting the exchange of currency. Payment to persons outside the country is subject to withholding taxes at a rate of 12.5 per cent if the service rendered by the foreign party to the Panamanian taxpayer affects the preservation or generation of Panamanian-source income.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Panama? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Tax legality is among the fundamental rights enshrined in the Political Constitution of the Republic of Panama, which means that all taxes and revenue schemes must be enacted into law. The Tax Code (Law No.8 of 1956 plus its successive reforms) is the principal body of law governing the country’s taxation system. The hallmark of Panamanian taxation is strict adherence to the principle of tax territoriality. Thus, article 694 of the Fiscal Code specifies that only “taxable income generated from any source within the territory of the Republic of Panama regardless of where it is received” is subject to income tax. Said article clearly envisions certain activities as not taxable within the Panamanian territory by not considering them to be income:

a. Invoicing from a business within Panama for the sale of merchandise or products for an amount greater than that for which such items had been invoiced to a business within Panama, whenever said merchandise or products do not physically enter Panama.

b. Supervise, from an office within Panama, business transactions performed, completed, or having effect abroad (offshore operations).

c. Distribute dividends or shares of juridical persons, when these originate from income not produced within the territory of the Republic of Panama, including that generated by activities listed under a. and b. above.

If a natural or juridical person perceives income from both Panamanian and non-Panamanian sources, tax is liable only against that portion obtained from a Panamanian source.

Any natural or legal entity that must remit to a natural or legal entity not residing in Panama sums derived from income of any kind produced in Panamanian territory, except for dividends or participations, must deduct and withhold, at the time of remittance, the amount established in articles 699 or 700 of the Tax Code and shall pay the withheld sums to the tax authorities within ten (10) calendar days from the date of withholding.

To calculate the withholding amount, the sums paid, drawn, credited or advanced to the taxpayer during the year must be added to the amount paid, drawn, credited or advanced and to 50 per cent of this sum the rate of articles 699 or 700 shall be applied. From the amount so established the withholdings already made in the taxable year shall be deducted. Currently, the withholding rate is 12.5 per cent.

By means of Law No.18 of 19 June 2006, certain provisions of the Tax Code were amended, including article 701, which establishes new rules for the application of capital gains tax derived from the sale of bonds, shares, participation quotas and other securities issued by legal persons, as well as capital gains arising from the transfer of other movable properties.

Except for shares registered with the National Securities Commission and if transfer (i) is made through a stock exchange or other organised market, or (ii) results from a merger or corporate reorganisation or consolidation and the shareholder only receives other shares in the surviving entity or its affiliate, which are exempt from capital gains tax, the following events are now subject to income tax, at a fixed rate of 10 per cent: (1) capital gains resulting
from the transfer of bonds, shares, participation quotas and other securities issued by Panamanian companies; (2) capital gains derived from the transfer or sale of other movable assets; and (3) capital gains derived from the transfer of securities resulting from the acceptance of a public offer for the purchase of shares, pursuant to the Securities Law.

Income produced by capitals or securities that are economically invested in the territory of Panama, regardless of whether the sale is executed in or outside of Panama is considered Panamanian-source income and thus, taxable.

The buyer of the shares has the obligation to withhold, from the payment to the seller, five per cent of the total amount of the transfer, on account of income tax payable on the seller’s capital gains. The buyer has the obligation to send payment to the Tax Authorities within 10 days following the date the obligation to pay arose. If there is a breach of this obligation, the issuer company is jointly liable for the payment of the unpaid tax.

The seller has the option to consider the sum withheld by the buyer (five per cent) as the definitive income tax to pay for the capital gains. If the sum withheld exceeds the amount resulting from the application of the 10 per cent rate to the gain obtained from the sale, the seller may file a special tax return to credit the sum retained and claim the excess resulting as a credit in his favour. This credit may be assigned to other taxpayers. The sums obtained from the transfer are not cumulated to the taxpayer’s taxable income.

9.2 Seller Tax Accounting. Does Panama require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Panama has traditionally adopted US GAAP, but regulations issued by the Internal Revenue Director now provide that the accounting standards of the International Accounting Standards Board (IASB) must be applied to companies that bill over US$ 1 MM.

9.3 Stamp Duty, etc. Does Panama impose stamp duty or other documentary taxes on sales of receivables?

As a general principle, stamp taxes are collected via sworn statements or by any other means authorised by the Revenue Directorate General of the Ministry of Economy and Finance. The person obligated to pay this tax should submit to the Revenue Directorate General sworn statements attesting to the number of executed documents liable for tax, the total amount of the face value on them, and the amount of corresponding tax payable.

The stamp tax ranges from US$ 0.01 to US$ 20. The general tax provision that establishes the stamp tax indicates that the tax is US$ 0.10 per US$ 100 fraction of value of the document or transaction, which equals to US$ 1 per US$ 1,000.

This provision states that all contracts that do not have a special tax and that refer to acts that are subject to the Panamanian jurisdiction must be stamped. The general provision contains certain exceptions: documents that refer to matters that do not generate taxable income in Panama are exempt from the stamp tax, unless the documents must be used or filed before Panamanian courts or administrative authorities, in which case, the stamp tax must be paid in order when the documents will be presented/used/filed in Panama. This means that if the contract refers to a transaction that does not generate taxable income, then the stamp tax is paid only when, and if, the document is enforced in Panama or if any registration is required.

Under our securities laws, any securities listed with the Superintendence of the Securities Market, as well as any document, contract or agreement related to their issuance, subscription, sale, payment, swap or redemption are not subject to stamp taxes.

9.4 Value Added Taxes. Does Panama impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

A seven per cent value added tax is levied on the transfer of movable assets in the Republic of Panama and the rendering of services by merchants, manufacturers, professionals, lessors and other service providers. The sale of receivables would not trigger the tax, since these are considered intangible rights. In addition, the transfer and negotiation of securities listed in the Superintendence of the Securities Market or that are negotiated through a stock exchange or any other organised market is exempt from capital gains taxes in Panama.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

The withholding obligation imposed by law on the seller with respect to the value added tax of seven per cent solves this issue. There is no express obligation either on the buyer or seller to pay the stamp tax; generally this is agreed to in the contract, but in the absence of any provision imposing the obligation, the authorities may enforce the payment on either party.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Panama, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Panama?

No, it would not be considered doing business in Panama.
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Poland

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Under Polish law, a legally binding contract may be concluded in any form, even as a result of the behaviour of the parties. However, there are some exceptions, in particular when the contract relates to the sale of real properties, the law requires a form of a notary deed, otherwise the transaction is null and void. The sale of chattels or services being subject to VAT requires the issuance of an invoice. It is common practice between business entities cooperating on a regular basis that a sale is evidenced by an invoice only. Invoices prove the fact that a sale took place and will be sufficient where the law does not require a particular form of a contract.

However, in certain cases, when specific provisions should apply, the law does require a particular form of contract; e.g. a retention of title clause is effective towards the creditors of a purchaser only if it is in writing and certified by an authority or notary public.

1.2 Consumer Protections. Do Polish laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Under Polish law the maximum interest rate per annum cannot be higher than four times the lombard rate of the National Bank of Poland. The current maximum interest rate amounts to 19 per cent annually. This maximum interest rate applies to any kind of receivables, inter alia, consumer credit, loans, etc.

Furthermore, Polish law provides a statutory right to interest on late payment (statutory interest rate). The statutory interest rate currently amounts to 13 per cent per annum. This rate applies unless the parties decide otherwise.

For consumers, the standard time bar period under Polish law is three years. It must be noted that the expiration of the time bar does not cancel the receivable itself. It cancels only a creditor’s right to demand fulfillment of this receivable.

In addition, it must be noted that Polish law significantly limits freedom of contract when a consumer is a party to the contract. A number of clauses cannot be used in contracts with consumers; a list is published by the unfair competition authority.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

The same legal provisions govern the sale and collection of receivables arising from contracts executed with both governmental and non-governmental entities.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Poland that will determine the governing law of the contract?

The governing law of contracts under Polish law will be determined under Regulation No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I).

According to the Rome I regulation, if the parties do not specify a governing law, the type of contract will determine which law applies; e.g. contracts for the sale of goods/provision of services will be governed by the law of the country where the seller/the service provider has his habitual residence, but contracts relating to rights in real estate will be governed by the law of the country where the property is situated.

2.2 Base Case. If the seller and the obligor are both resident in Poland, and the transactions giving rise to the receivables and the payment of the receivables take place in Poland, and the seller and the obligor choose the law of Poland to govern the receivables contract, is there any reason why a court in Poland would not give effect to their choice of law?

No, in such circumstances, the laws of Poland would apply; a Polish court would not apply foreign laws.
2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Poland but the obligor is not, or if the obligor is resident in Poland but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Poland give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In general, the law chosen by the parties takes priority over local law. However, if a foreign law would have consequences contrary to the fundamental principles of public policy in Poland, a Polish court may refuse application of such foreign law. Furthermore, a court may apply such provisions of Polish law which are applicable to any situation falling within their scope, irrespective of the choice of foreign law.


3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Poland law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Polish laws or foreign laws)?

Yes, Polish law sets out that the sale of receivables is governed by the same law as the law governing the receivables. This rule applies irrespective of which law governs the receivable.

3.2 Example 1: If (a) the seller and the obligor are located in Poland, (b) the receivable is governed by the law of Poland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Poland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Polish law, will a court in Poland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor) regardless of the fulfilment of requirements of the law of the obligor’s country or the purchaser’s country (or both).

Yes, in such circumstances a court will recognise the sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor).

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Poland, will a court in Poland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

In such a case, a court will recognise the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) regardless of the fulfilment of requirements of the law of the obligor’s country or the purchaser’s country (or both).

3.4 Example 3: If (a) the seller is located in Poland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Poland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Polish own sale requirements?

In such a scenario, in most typical cases, a court should recognise the sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) regardless of the fulfilment of requirements of Polish law. However, it must be noted that if the foreign law would have consequences contrary to the fundamental principles of public policy in Poland, a court may refuse application of such foreign law. Furthermore, a court may apply such provisions of Polish law which are applicable to any situation falling within their scope irrespective of the choice of foreign law.

3.5 Example 4: If (a) the obligor is located in Poland but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Poland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Polish own sale requirements?

Please refer to the answer to question 3.4 above.

3.6 Example 5: If (a) the seller is located in Poland (irrespective of the obligor’s location), (b) the receivable is governed by the law of Poland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Poland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Poland and any third party creditor or insolvency administrator of any such obligor)?

Under Polish law, the sale of a receivable is governed by the same law as the law governing the receivable. Thus, if the receivable is governed by Polish law, requirements of Polish law must be met in order that the sale be recognised effective against the seller and other third parties, despite the fact the seller and purchaser have chosen foreign law for the sale of this receivable.
4 Asset Sales

4.1 Sale Methods Generally. In Poland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The customary method in Poland for the sale of receivables is to execute a contract for assignment of receivables with a purchaser. In Poland, the transfer of receivables is customarily called an assignment.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

Under Polish law, the assignment of a receivable must be executed in written form only if the receivable is stated in writing, which is the most typical case. It must be noted that this rule applies even if the receivables contract has not been executed in writing, but an invoice has been issued. In such circumstances the assignment agreement should also be executed in writing.

If the receivable is not stated in writing, a written form of an assignment is not required. It is, however, recommended for evidentiary purposes.

The assignment, from its execution, is effective towards the obligor, but until the obligor has been notified about the assignment, he can effectively fulfill his obligation to the seller unless he knew about the assignment.

There are no other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller. The subsequent assignment of the same receivable by the initial seller will be null and void.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under Polish law, promissory notes are typically transferred by endorsement unless the clause “not to the order” is on the note. If such a clause exists, the note may be transferred only by means of an ordinary assignment. Moreover, in each case, it is necessary to hand over the note to the purchaser in order to perfect the transaction.

Assignment of a mortgage loan, in most typical cases, transfers the mortgage to the purchaser as well. In order to perfect such an assignment, the purchaser must be entered into the land and mortgage register.

Transfer of a consumer loan is permissible under Polish law. However, the agreement for such a loan cannot stipulate that, in the event of an assignment, some defects due to the consumer are excluded. Such provision will be ineffective under the law on consumer loans.

Different requirements apply to the transfer of various types of marketable debt securities. In general, Polish law permits the assignment of such rights, but, when a right is evidenced by a document, a transfer of this document would usually be required for assignment.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Under Polish law, a receivable may be assigned without an obligor’s consent.

A sole assignment contract will be sufficient for the sale to be effective against creditors of the seller.

As stated in question 4.2 above, notification of the obligor is necessary for the assignment to be effective against the obligor. If the notice is not served the obligor can fulfill the relevant obligation direct to the seller with an effect against the purchaser. In such an event the purchaser cannot pursue the obligor but must seek compensation form the seller.

If the receivables contract expressly prohibits assignment, an attempted assignment will be ineffective. In other cases, where there is no prohibition but no express permission either, assignment will be possible unless it is prohibited by law or the character of the relationship from which it arises.

Regardless of the notice the obligor can set off his/her receivables against the seller with receivables transferred to the purchaser even after the notice. The obligor keeps all defences against the seller after the assignment and may raise them against the purchaser.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no special requirements regarding the form of notice. However, for evidentiary purposes it should be delivered in writing.

There is no time limit for delivery of the notice, but it would be reasonable to serve it as soon as the assignment was executed. The notice can be delivered after the commencement of insolvency proceedings against the obligor, but it must be noted that if the assignment took place after the insolvency proceedings have commenced, the purchaser may be limited in his right to set off such receivables with receivables of the obligor towards him.

The notice may apply to a whole group of receivables provided that there are no doubts which receivables have been transferred (it can also apply to specified future receivables). However, from the purchaser’s point of view, it would be better to inform the obligor precisely that specific receivables should be paid directly to him, not to the seller. Otherwise the fulfillment of the obligation by the obligor to the seller after the assignment can have effects against the purchaser if the notice served was imprecise.
4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Poland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Poland recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Under Polish law, a receivable cannot be assigned if the receivables contract prohibits assignment. An assignment attempted in breach of a receivables contract is ineffective. In such circumstances, the seller will be liable to the purchaser for breach of contract. Liability of the seller to the obligor is also possible but the latter must prove damage incurred by the assignment.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must specifically identify receivables to be sold. However each of the receivables do not have to be identified individually. It is possible to identify a whole group of receivables, e.g. receivables which arise from a specific contract between the parties from one date to another date.

The receivables being sold do not have to share objective characteristics.

A sale of all receivables without further identification might be considered insufficient to transfer all those receivables effectively. The risk of improper notification or identification is on the purchaser. Thus for the purchaser’s security the obligor should be informed precisely which receivables have been assigned. Otherwise the fulfilment of the obligation by the obligor to the seller after the assignment can have effects against the purchaser if the notice served was imprecise.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

If an agreement is executed in writing, it is denominated as a sale agreement and it expresses a clear intention of the parties to sell an object or right for a particular price, then such an agreement will be respected unless it is proved that it was e.g. a sham agreement. Sham agreements are generally null and void under Polish law. However if a sham agreement is made to conceal another legal act; e.g. a sale concealing a donation, such an agreement may be valid if certain conditions are met. To establish whether an agreement was a sham, a court may examine whether the price was paid or the other obligation of the parties were performed, but the scope of examination will depend on specific circumstances.

Under Polish law the seller, without jeopardising perfection, may retain credit risk, interest rate risk and a right of repurchase/redemption. Retention of control of collections may be deemed contrary to the nature of the assignment but it should be assessed in the circumstances of each specific case.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables and when they arise)?

Yes, continuous sales of receivables are possible under Polish law. Such future receivables, arising from one or a few particular legal relationships, will be effectively transferred when they come into existence.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Yes, the sale of future receivables is possible under Polish law. If the future receivable is strictly defined in the assignment agreement (i.e. in a manner which excludes doubts as to which receivable is being transferred) then this receivable will be transferred effectively when it comes into existence without any other acts of the parties. If not, a further confirmation of assignment will be necessary.

It should be added that under Polish law, on declaration of bankruptcy, a bankrupt entity will lose its right to manage its estate. Consequently it cannot validly and effectively sell its receivables. Furthermore, acts of disposition executed by the bankrupt up to 12 months before filing of the bankruptcy petition may be declared ineffective if gratuitous or if considerations of the parties are severely disproportionate.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Under Polish law, the method of transfer of related securities will depend on the type of security. There are types of security which pass automatically with the sale of a receivable, those which require registration with the relevant authorities to pass, and those for which a transfer will depend on the parties’ decision. For example: a civil pledge passes automatically for the purchaser of a receivable, a registered pledge and mortgage pass after the registration of the purchaser with the relevant registry, and a bank guarantee passes only if the parties decide so.
5 Security Issues

5.1 Back-up Security. Is it customary in Poland to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No. It would be considered unusual if the parties to a receivables sale contract assumed at any stage of the transaction that the sale could be deemed not perfected by the court. Furthermore, such security could only be conditional on the court issuing a final decision of invalidity of the sale, because at the moment of the sale being effective (if not finally declared otherwise by the court) the receivables are owned by the purchaser and not by the seller.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Poland, and for such security interest to be perfected?

Please refer to the response to question 5.1 above. If the security is a registered pledge, the formalities include a written agreement and registration in the Polish public pledge register. If the security is a conditional assignment, it is required to be in written form. If such conditional assignment is supported by a submission to enforcement (poddanie się egzekucji), it will require a notarial deed. An ordinary pledge on receivables requires a form with certification of date and notification to the receivables’ debtor; the same formalities plus registration in the land and mortgage register are required for a mortgage on a receivable secured by a mortgage.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Poland to grant and perfect a security interest in purchased receivables governed by the laws of Poland and the related security?

Please refer to the response to question 5.2 above.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Poland, and such security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Poland or must additional steps be taken in Poland?

This is an unusual situation and not market practice, as normally Polish law receivables are subject to Polish law security. In most cases it should be treated as valid and perfected in Poland, subject to the enforcement procedure requirements, which may include certain additional steps to be taken. The scope of the enforcement procedure requirements depends on whether the (court) award providing the basis for enforcement comes from an EU country or a non-EU country.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Insurance policies: a written agreement is required.

5.6 Trusts. Does Poland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Trusts are not recognised in Polish law and it is unlikely that an alternative mechanism would be effective. The purchaser has a valid claim against the seller requiring the seller to turn over collections paid to the seller by a debtor acting in good faith, but these collections are not separated from other assets of the seller.

5.7 Bank Accounts. Does Poland recognise escrow accounts? Can security be taken over a bank account located in Poland? If so, what is the typical method? Would courts in Poland recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Poland?

Yes, Polish banking law recognises escrow accounts. Yes, security can be taken over a bank account located in Poland; more precisely, over receivables from the bank account agreement. Typical methods for taking bank account security are: registered pledge; security assignment of rights; financial pledge; and power of attorney to the relevant bank account (which is a quasi-security measure).

In relation to foreign law recognition, please refer to the response to question 5.4 above.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

A security over a bank account is possible under Polish law. Typically the bank account security can be: i) registered pledge over rights to bank account; ii) financial pledge over bank account; or iii) security assignment of rights to bank account. Typically, full control over all cash flowing into the charged bank account is possible under items ii) and iii). For item i) the enforcement is more complicated and may involve court enforcement proceedings.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, the owner of the account can have access to the funds in the account prior to enforcement without affecting the security.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Poland’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Subject to certain clawback provisions (see below) and if the sale of receivables has been perfected, there is no automatic stay under Polish law against the purchaser.

Under Polish insolvency law, the decisive issue will be whether an asset is classified as part of the bankruptcy estate or not. If the receivables transferred to the purchaser as a secured party are determined by the insolvency official to be part of the bankruptcy estate, the purchaser will not be able to exercise the rights stated above in relation to the receivables. If the receivables transferred are determined not to be part of the bankruptcy estate, the owner will be able to exercise ownership rights.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Further to the response to question 6.2 above, if the receivables are not part of the bankruptcy estate and if there is no clawback, the insolvency official does not have any such powers.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Poland for (a) transactions between unrelated parties and (b) transactions between related parties?

Polish insolvency law (prawo upadłościowe i naprawcze) provides for a number of clawback rules, including (but not limited to):

- i) provisions of a contract, which provide for a change to, or termination of, such contract on declaration of bankruptcy, are invalid;
- ii) legal transactions made during the year prior to filing the motion for bankruptcy, where such legal transactions have been made by the insolvent without consideration or for consideration disproportionately lower than the consideration, asset, service, etc. received by the insolvent under the same;
- iii) granting security for, or payment of, a debt not yet due, made during the two months prior to filing the motion for bankruptcy (although a beneficiary can claim to consider these actions valid if the beneficiary did not know grounds for bankruptcy at the moment of accepting the security or receipt of the payment);
- iv) legal transactions made with consideration during the six months prior to filing the motion for bankruptcy with certain related parties (e.g. shareholders); and
- v) pledge, registered pledge, mortgage or maritime mortgage – established by the insolvent during the year prior to filing the motion for bankruptcy – if the insolvent has not been a personal debtor of the secured creditor and in relation to the security the insolvent has not received any consideration; the clawback action here begins upon the motion of the receiver and is subject to the decision of the judge-commissioner.

If any asset (including receivables) is transferred by the seller to the purchaser as a security for the seller’s obligation towards the purchaser, the transferring contract, in order to be effective against the bankruptcy estate (i.e. to avoid clawback), has to be signed with a certification of the date (data pewna).

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Substantive consolidation, as described in the question above, is not possible under Polish insolvency law.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Poland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Under Polish insolvency law, there are two types of insolvency proceedings: i) with liquidation of assets; and ii) with the possibility of making an amicable agreement with creditors.

In the first type of insolvency proceedings, the insolvent entity is deprived of its assets (which become the bankruptcy estate) and is not allowed to manage them in any way – therefore any actions including a sale of receivables can be performed by the receiver. If there is a general agreement under which the insolvent is obliged to sell receivables and receivables that have not yet been transferred but exist, they become due and payable as at the day of declaration of bankruptcy. The receiver, however, can rescind such a general agreement.

In the second type of insolvency proceedings, if there is a general agreement under which the insolvent is obliged to sell the receivables, such obligations cannot be performed until the amicable agreement becomes final or the proceedings are finally redeemed.

The comments above should also relate to future receivables, as the initiation of insolvency proceedings does not impair their coming into existence under the base contract.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Poland establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no special securitisation law in Poland and the term “securitisation” is not legally defined in Polish law. The existing legal framework for securitisation transactions concerns bank receivables and is set by two legal acts:

- i) banking law (prawo bankowe); and
ii) law on investment funds (ustawa o funduszach inwestycyjnych).

Further to the above, Polish law provides for a securitisation mechanism for bank receivables using an investment fund or securitisation fund structure regulated by the law on investment funds. The securitisation is done through a receivables assignment agreement or sub-participation agreement made between the bank and the securitisation fund. The other party can also be a company limited by capital for issue by such company of the securities secured on the (transferred) receivables. It is also possible to enter into a loan risk transfer agreement using a loan derivative instrument.

7.2 Securitisation Entities. Does Poland have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Please refer to the response to question 7.1 above. There are no specific laws in Poland relating to securitisation. Under the banking law, the securitisation entity can be an investment fund creating a securitisation fund, a securitisation fund or a company limited by capital issuing securities secured on the (transferred) receivables. For the latter, such a company cannot be related by means of capital or organisation with the bank and such company can trade only within the limited scope indicated above.

Requirements for the establishment and management of investment funds and securitisation funds are set out in the law on investment funds. An investment fund can be created only by an investment fund association. An association manages the fund. Creation of a securitisation fund requires consent of the Polish Financial Supervision Authority (Komisja Nadzoru Finansowego).

A securitisation fund is a close-ended investment fund, issuing investment certificates (certyfikaty inwestycyjne). A securitisation fund (like an investment fund) is a legal person. There are two types of securitisation fund: standardised; and non-standardised, which differ in as to their permitted investment portfolio.

The directors of an investment fund association are required to fulfil certain criteria set out in the law on investment funds. Minimum requirements are full legal capacity, clear criminal record and good reputation in relation to the performed functions. At least two board members, including the president of the board need to fulfil further specific requirements (including experience requirements).

7.3 Non-Recourse Clause. Will a court in Poland give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

This should be recognised by a court in Poland as an effective contractual provision, if the party whose recourse is limited has agreed directly in the agreement (except in cases of gross negligence or wilful misconduct of the party for whose benefit the recourse is limited).

7.4 Non-Petition Clause. Will a court in Poland give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

These provisions would be very far-reaching, even for a commercial, non-consumer contract in Poland. A Polish court may, therefore, be willing to hear arguments purporting legal defects or even the invalidity of such provisions.

7.5 Priority of Payments “Waterfall”. Will a court in Poland give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Such provision is possible and should be considered enforceable by a court in Poland if it does not change the priority of satisfaction of the creditors under the civil enforcement procedure or under the insolvency proceedings.

7.6 Independent Director. Will a court in Poland give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

This structure would be highly unusual. If such a restriction of directors’ powers were contained in a company’s organisational documents, this would not have external application, i.e. if a “limited” director undertakes any legal action with a third party without the affirmative vote of an independent director, such legal action will be valid and effective; the company has only a potential claim against the “limited” director for damage caused as a result of the action in breach of the company’s organisational document.

For insolvency specifically, a director can be held liable for a company’s debts, if enforcement against the company is ineffective and if the director does not file a motion for bankruptcy in due time. Each director therefore has a right and an obligation to file a motion for bankruptcy of a company in due time, if such company is insolvent or has excessive indebtedness, notwithstanding the vote of any third party.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Poland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Poland? Does the answer to the preceding question change if the purchaser does business with other sellers in Poland?

The Polish Banking law of 29 August 1997 defines a financial institution as an undertaking other than a bank or a credit institution, whose core operations, being the source of the major part of its income, consist in conducting business activities involving, inter alia, providing debt trading services. A foreign financial institution whose registered office is located in an EU Member State must meet the...

The legal situation would differ in circumstances where the purchaser establishes a Polish entity, where he must meet the requirements set up the Law on freedom of economic activity of 2 July 2004, as well as other general requirements set up for Polish entities.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Representation before a court in Poland is an activity reserved for qualified persons, including legal advisors and advocates, but also employees of a represented entity as well as any person with whom such entity has concluded a permanent mandate relationship (stały stosunek zlecenia).

For collection of receivables, the formal enforcement procedure must be carried out by a bailiff, who is authorised to use coercion. Some activities may also be covered by the Law on detective services of 6 July 2001. Conducting detective services is a regulated activity and requires entry into the register of detective activities. In addition, any person providing detective services must hold a licence.

8.3 Data Protection. Does Poland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The personal data protection Act of 29 August 1997 sets out the key rules for processing personal data. Personal data is allowed to be revealed to a purchaser, even without the debtor’s consent, provided that due regard is paid to the protection of fundamental rights, freedom and the privacy of the data subject.

The Law on access to economic information and business data exchange of 9 April 2010 also applies in this respect, which, in particular, sets out conditions for revealing a consumer’s personal data to the economic data bureau.

The Banking Law sets out conditions for exceptions to the banking secrecy obligation regarding the data of debtors whose debts are to be sold. The Banking Law sets out specific rules for processing personal data which must be observed by banks and other listed entities.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Poland? Briefly, what is required?

Please see comments above regarding consumer data protection. The purchaser will also be required to observe consumer rights when conducting its activities. Pursuant to the Law on competition and consumer protection of 16 February 2007, the President of the Office of Competition and Customer Protection (President of UOKiK) is authorised to issue a decision identifying a practice as infringing collective consumer interests and ordering that the same be discontinued, as well as impose a fine on the infringing entity. The President of UOKiK has historically exercised these powers towards debt collection as well as other entities.

8.5 Currency Restrictions. Does Poland have laws restricting the exchange of Polish currency for other currencies or the making of payments in Polish currency to persons outside the country?

The Foreign Exchange Law of 27 July 2002 regulates foreign exchange turnover with other countries and trading in foreign exchange in Poland, as well as business operations which consist of buying and selling foreign exchange values, and brokerage services with respect to buying and selling foreign exchange values. Generally, these restrictions apply to relations with third countries which are states other than the Republic of Poland, Member States of the European Union, or Members of the European Economic Area or the Organization for Economic Cooperation and Development. These restrictions apply, in particular, to:

- the acquisition by residents (both directly and through other undertakings) of foreign exchange values sold by non-residents from third countries, or claims and other rights, the exercise of which involves money settlements, sold by non-residents from third countries; or
- the selling by residents (both directly and through other undertakings) in third countries, of claims and other rights, the exercise of which involves money settlements, with the exception of those acquired in such countries under a foreign exchange permit or which have arisen in turnover with non-residents from third countries, to the extent not requiring such a permit; and
- money settlements by residents and non-residents from third countries in performance of actions mentioned above, excluding actions which do not require a foreign exchange permit.

Departures from these restrictions may be authorised by a general or individual foreign exchange permit.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Poland? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Whether payments on receivables are subject to withholding tax in Poland depends on the characteristics of the receivables. Polish tax law stipulates situations when an obligor would be required to withhold tax. These include, but are not limited to, royalties and interest payments as well as remuneration for intangible services and lease of real estate located in Poland.

The maximum standard withholding tax rate for these is 20 per cent, subject to applicable double tax treaties and special measures available to transactions between related EU entities.

The treaty rates for interest and royalties are between 5 per cent and 15 per cent. Moreover, a number of double tax treaties provide for a general exemption for any interest payments or interest paid on bank loans, subject to additional prerequisites.

The majority of trade debts, however, would not be subject to withholding tax, unless there is an interest component. This also applies to repayment of principals of loans and credits.

There are no specific measures applying with regard to maturity or the location of the recipient of payment, although for tax havens there would be no double tax treaty available.
9.2 Seller Tax Accounting. Does Poland require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

There is no specific mandatory accounting policy with regard to securitisation.

9.3 Stamp Duty, etc. Does Poland impose stamp duty or other documentary taxes on sales of receivables?

Please see the response to question 9.4 below.

9.4 Value Added Taxes. Does Poland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Stamp duty applies to sales of receivables which are not subject to VAT or are VAT-exempt. Stamp duty is calculated as 1 per cent of the market value – usually the agreed price. The purchaser is the sole taxpayer.

Historically, sales of receivables, in particular when carried out for a price below their nominal value, were often interpreted as debt administration services. The service provider was the purchasing party and the services were deemed to consist in lifting the risk from the original obligor and contributing to the obligor’s cash flow. Such services, if considered factoring, were subject to 22 per cent (until 1 January 2011) and 23 per cent (since 1 January 2011) VAT. If considered other financial services – they were VAT-exempt. Either way, if the transaction was subject to VAT (including VAT-exempt) no stamp duty was triggered.

Notwithstanding the above, the Court of Justice of the European Union (CoJ) on 27 October 2011 delivered judgment in case GFKL Financial Services AG C-93/10 on the application of EU VAT provisions to sales of bad debts. CoJ ruled that the negative difference between the nominal value of the receivables and the price for which the receivables are sold may not be considered remuneration for services rendered by the purchasing party. Hence, the sale of receivables should be considered a straightforward sale of rights.

The immediate effect of this judgment was that sales of receivables were no longer considered by the Polish tax authorities as taxable transactions for VAT purposes. This approach seems to remain dominating at the beginning of 2013.

Moreover, where the tax authorities rule that purchase of receivables for their collection are taxable transactions for VAT purposes, they tend to consider them VAT-exempt financial services.

This basically means that the sale of receivables should, in general, be considered subject to stamp duty at 1 per cent.

Notwithstanding, collection agent services where the agent does not purchase the receivables but collects receivables of another party, would most probably be subject to VAT without any exemption available.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Stamp duty is payable by the purchaser only.

Before the CoJ judgment referred to above, and since 2010, in the case of an intra-community transaction when:

- a sale of receivables was considered services rendered by their purchasers;
- these services were subject to VAT and were not VAT-exempt; and
- the seller was a trader as defined in the VAT regulations,

the seller was required to settle the VAT on a reverse charge basis. In cases of failure to comply, the tax authorities would not make claims for the unpaid tax against the purchaser or against the sold receivables or collections.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Poland, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Poland?

The purchase of receivables would not be considered a taxable event for the purchaser under the income tax provisions in Poland.

If the seller is acting as a dependent agent of the purchaser, and services and collects the receivables on the purchaser’s behalf, the purchaser would be deemed to have a permanent establishment in Poland. Consequently, the income received through or in relation to activities of the agent could be taxable in Poland.

If there is no permanent establishment in Poland, income received from Polish sources could, in general, be exempt in Poland, provided that there is a double tax treaty available and no withholding tax applies.
Marcin Gruszko, a Polish legal adviser, has been with TGC Corporate Lawyers since 2001 and is director of the firm’s banking and finance practice. He advises Polish and foreign banks and companies on loan and credit facilities (senior and mezzanine credit facilities, syndicated lending), inter-creditor documents, taking security and the perfection of security, project finance, real estate finance, foreign exchange and all other matters that arise in banking transactions. Marcin acts for major multinationals and entrepreneurs as well as major financial institutions including a number of the top 10 international banks. He also has significant expertise in the following areas: mergers and acquisitions; transformations and stock market listings; joint ventures; capital markets; dispute resolution; and real estate transactions.

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Through our network of offices in Central Europe we are able to provide clients with expert, local knowledge throughout Poland (Warsaw, Wrocław, Łódź and Kraków), the Czech Republic (Prague and Brno), and Slovakia (Bratislava).
Chapter 32

Portugal

Vieira de Almeida & Associados

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

The legal requirements applicable to the form of a contract between a seller and an obligor depend to a large extent on the nature of the contract (if it is a loan agreement made by a bank to a customer, an agreement between a utility company and a customer, etc.). As an example, the general rule applicable to the granting of credit facilities to consumers is that the relevant contract has to be in writing. The general civil law principle, however, (i.e. the rule which applies by default whenever there is no specific rule applicable to a certain type of contractual relationship), is that there is no prescribed generally applicable formality for contracts to be entered into, and therefore a valid contractual relationship for the sale of goods and services can even be established orally (unless otherwise stated in a specific legal provision), and in those circumstances the existence of an invoice is naturally also sufficient to document the relevant contract.

In order for a receivables contract to be deemed to exist as a result of the parties’ behaviour alone, it has to be possible to conclude, based solely on the parties’ actions, that their intention was to enter into a contract. In other words, the parties’ behaviour has to be, for all purposes, equivalent to a contractual statement.

1.2 Consumer Protections. Do the laws of Portugal (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) As a general rule, the Portuguese Civil Code foresees a legal interest rate. This rate is currently set at 4 per cent. Any stipulation of an interest rate superior to the legal rate must be made in writing. Also, stipulated rates may not exceed the legal interest rate by more than 3 per cent (if the obligation is secured) and by more than 5 per cent (if it is not). Interest stipulated over these limits is deemed reduced to the aforementioned maximum rates.

The general rules described in the previous paragraphs do not apply to credit institutions. However, in accordance with the Portuguese legal framework for consumer credit (Decree-Law no. 133/2009, dated 2 June 2009, implementing Directive 2008/48/CE on consumer credit agreements), the Annual Percentage Rate of Charge charged by credit institutions to consumers (including in relation to leasing transactions) is limited to a three-month average disclosed by the Bank of Portugal plus one third of that average. For the second quarter of 2013, this means that the maximum Annual Percentage Rate of Charge for consumer credit is (i) 26.5 per cent, for personal loans (other than loans for specific purposes such as health or education, or financial leases of equipment) and for credit cards, credit lines, current accounts or overdraft facilities, and (ii) between 8.9 and 16.9 per cent for automobile loans (depending on whether the vehicle is new or used. An amendment to Decree-Law no. 133/2009 shall enter into force on 1 July 2013 limiting the maximum Annual Percentage Rate of Charge for consumer credit regarding (i) personal loans (other than loans for specific purposes such as health or education, or financial leases of equipment) to 19.5 per cent, and (ii) credit cards, credit lines, current accounts or overdraft facilities to 27.5 per cent.

(b) As a general rule, the Portuguese Civil Code applies delay interest. As per (a) above, the legal delay interest rate is set at 4 per cent, except if the remuneratory interest (i.e. interest charged under (a) above) is higher, or if the parties agree on a higher delay interest rate. Similar to (a) above, stipulated delay interest rates may not exceed the legal delay interest rate by more than 7 per cent (if the obligation is secured) or by more than 9 per cent (if it is not). Delay interest stipulated over these limits is deemed reduced accordingly.

However, under the Portuguese Commercial Code, where the creditor is a commercial company (which may be a legal or a natural person, for instance an individual merchant acting as such) a special delay interest rate applies. At the moment, this rate is set at 7.75 per cent. The limitations to stipulated delay interest rates mentioned in the previous paragraphs also apply, with the legal rate being 7.75, instead of 4, per cent.

With regard to credit institutions, there is a special framework (Decree-Law no. 344/78, dated 17 November 1978) which also limits the delay interest rate which may be charged. In accordance with this special framework, credit institutions may stipulate delay interest rates of up to 4 per cent over (i) the rate which would be applied to the transaction if it had been renewed, or (ii) to the maximum permitted interest rate for active transactions of similar maturity. An amendment entering into force on 1 July 2013 shall lower this limit to 3 per cent.

There is, in most circumstances, an unconditional right to terminate the receivables contract during the initial 14 days after execution, in which case the advanced amount is given back to the lender and the contractual relationship terminates, but the financial institution may not charge any additional fees with regard to the termination.

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Under the Portuguese consumer credit legal framework, financial institutions may only carry out the acceleration of defaulted loans (or terminate the relevant agreement) when more than two instalments (totalising more than 10 per cent of the entire amount outstanding) are due and only following notification to the debtor to that effect, granting him at least 15 days to pay the amounts due and expressly warning him of the possibility of accelerating the loan. Other rights mostly relate to information and contents obligations, the right to render the contract void or voidable if information is not provided, etc.

Public procurement rules may apply. If the government is acting under private law, it should not have special prerogatives. In any case, specific rules may apply in relation to issues such as the validity of a delegation of powers.

If the parties fail to specify the law chosen to govern the receivables contract, it should first be considered whether EC Regulation no. 593/2008 ("Rome I Regulation") or the Rome Convention on the law applicable to contractual obligations ("Rome Convention") apply to the relevant conflict.

If the Rome I Regulation or the Rome Convention apply, then Article 3 of the Rome I Regulation would allow the parties to choose a governing law. This choice would be subject to the limitations set out in the Rome I Regulation. Of these limitations, we believe those applicable to consumer contracts are probably those which would be more likely to apply in the context of a receivables contract, i.e. if the obligor is a consumer. Limitations in relation to public policy and mandatory principles of law also apply, but they would be less typical.

If the Rome I Regulation or the Rome Convention do not apply, the general principle in Portugal is that the parties may elect the governing law applicable. However, there are certain circumstances in which the parties are not entirely free to choose the law applicable to the whole or part of the contract. The parties may not choose foreign law with the intent of fraudulently avoiding Portuguese law. Furthermore, the choice of foreign law may not offend Portuguese international public policy.

Also, regardless of the applicability of the Rome I Regulation or the Rome Convention, if the obligor is resident in Portugal and to the extent that the receivables agreement could be deemed to include general contractual clauses (i.e. those which the obligor may only accept without prior individual negotiation), the choice of foreign law is likely not to preclude the full application of the provisions of Portuguese law on general contractual clauses.


Portuguese law does not generally require that an assignment of receivables is governed by the same law as the law governing the receivables themselves. If so, does that general rule apply irrespective of which law governs the receivables (i.e., Portuguese laws or foreign laws)?

If all of the relevant aspects of the receivables contract have a connection with Portugal, there is no reason why a Portuguese court would not give effect to the parties’ choice of Portuguese law as the law governing the contract. Please note, however, that there may be mandatory provisions of law in other jurisdictions requiring certain aspects of a contract to be governed by such law (for instance, if the transaction at stake pertains to, or is secured by, real estate property located in another jurisdiction).
3.2 Example 1: If (a) the seller and the obligor are located in Portugal, (b) the receivable is governed by the law of Portugal, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Portugal to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Portugal, will a court in Portugal recognise that sale as being effective against the obligor, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

We see no reason for a Portuguese court not to recognise the effectiveness of the assignment in this scenario, be it against the seller or against the obligor. The same may be said with regard to effectiveness towards the relevant third parties.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Portugal, will a court in Portugal recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

From a Portuguese law perspective, we understand that the fact that the obligor or the purchaser are located outside Portugal would not cause a Portuguese court to decide differently from Example 1, however any mandatory foreign law requirements would need to be complied with.

3.4 Example 3: If (a) the seller is located in Portugal but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Portugal recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Portugal’s own sale requirements?

In this scenario, if the assignment is valid under its governing law, we believe that a Portuguese court would recognise the sale as effective against the seller and any relevant third parties.

3.5 Example 4: If (a) the obligor is located in Portugal but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Portugal recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Portugal’s own sale requirements?

In this scenario, we also believe that a Portuguese court would recognise the sale as being effective, subject to the considerations made in the next few paragraphs.

If the obligor is a consumer and either the Rome I Regulation or Rome Convention apply, the choice of the seller’s country to govern the receivables agreement may not deprive the obligor of the protection granted by mandatory provisions of Portuguese law. We understand that the debtor notification requirements of the Portuguese Civil Code (when not waived by the application of the Securitisation Law) are mandatory provisions protecting the debtor and that, as such, the level of debtor protection enshrined in them must be met either by directly applying Portuguese law or provisions of the law of the seller’s country which provide the same level of protection.

If the obligor is a consumer and the Rome I Regulation and Rome Convention do not apply, we still believe that the reasoning of the previous paragraph should apply, as we understand that there would be a risk that a Portuguese court attempted to enforce a similar solution.

If the obligor is not a consumer, the assignment may be deemed valid if the obligor notification procedures mandated by the law governing the receivables agreement are followed.

In any case and from a risk mitigating perspective, we would recommend that all assignments of receivables owed by Portuguese resident entities be notified to the debtor in writing.

3.6 Example 5: If (a) the seller is located in Portugal (irrespective of the obligor’s location), (b) the receivable is governed by the law of Portugal, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Portugal recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Portugal and any third party creditor or insolvency administrator of any such obligor)?

If either the Rome I Regulation or Rome Convention apply, we believe that Portuguese courts would, under Articles 3 and 14 of the Rome I Regulation, recognise the choice of foreign law regarding the sale of the assets and would, as such, have no reason not to deem the sale effective against the seller. The same result would be achieved if neither the Rome I Regulation nor Rome Convention apply, in this case through the application of the general principle of the Portuguese Civil Code under which the parties are free to elect a governing law.

As for effectiveness against the obligor, if the receivable is governed by Portuguese law then the obligor is entitled to the protection granted to debtors by the mandatory provisions of Portuguese law applicable to assignments of receivables. As such, we would recommend that the debtor notification requirements of the Portuguese Civil Code (when not waived by the application of the Securitisation Law) are met in relation to the obligor.

4 Asset Sales

4.1 Sale Methods Generally. In Portugal what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

In the context of securitisation, the customary method for a seller to sell receivables to a purchaser is under the framework of the Securitisation Law, approved by Decree-Law no. 453/99, dated 5
November 1999, as amended from time to time (the “Securitisation Law”). The Securitisation Law has implemented a specific securitisation legal framework in Portugal, which contains a simplified process for the assignment of credits for securitisation purposes. In fact, the sale of credits for securitisation is effected by way of assignment of credits, such being the customary terminology.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

There are no specific formality requirements for an assignment of credits under the Securitisation Law. A written private agreement between the parties is sufficient for a valid assignment to occur (including an assignment of loans with underlying mortgages or other guarantees subject to registration under Portuguese law). Transfer by means of a notarial deed is not required. In the case of an assignment of mortgage loans, the signatures to the assignment contract must be certified by a notary public, lawyer or the company secretary of each party under the terms of the Securitisation Law, such certification being required for the registration of the assignment at the relevant Portuguese Real Estate Registry Office.

Additionally, the assignment of any security over real estate, or of an asset subject to registration, in Portugal is only effective against third parties acting in good faith further to registration of such assignment with the competent registry by or on behalf of the assignee. The assignee is entitled under the Securitisation Law to effect such registration.

In accordance with Article 6 of the Securitisation Law, the assignment of the relevant assets becomes immediately valid and effective between the parties upon the execution of the relevant assignment agreement, irrespective of the debtor’s consent, notification or awareness, when the assignor is, inter alia, a credit institution or a financial company.

When such is not the case, and in relation to the effectiveness of the assignment as far as the relevant debtors are concerned, the general rule is that a notification is required for the assignment to become effective, following the general principle under Article 583 of the Portuguese Civil Code.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

As mentioned in question 4.2 above, in order to perfect an assignment of mortgage loans and ancillary mortgage rights which are capable of registration at a public registry against third parties, the assignment must be followed by the corresponding registration of the transfer of such mortgage loans and ancillary mortgage rights in the relevant Real Estate Registry Office.

The Portuguese real estate registration provisions allow for the registration of the assignment of any mortgage loan at any Portuguese Real Estate Registry Office, even if the said Portuguese Real Estate Registry Office is not the office where such mortgage loan is registered. The registration of the transfer of the mortgage loans requires the payment of a fee for each such mortgage loan.

In what concerns promissory notes (“livranças”), the usual practice is for these to be blank promissory notes in relation to which the originator has obtained from a borrower a completion pact (“pacto de preenchimento”) which grants the originator the power to complete the promissory note. In order to perfect the assignment of such promissory notes to the assignee, the assignor will have to endorse and deliver these instruments to the assignee.

The assignment of marketable debt instruments in perfected by the update of the corresponding registration entries in the relevant securities accounts, in accordance with the Portuguese Securities Code.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

In what concerns obligor notification or consent and if the relevant receivables contract is silent in this respect, please refer to question 4.2 above. On the contrary, if the relevant receivables contract expressly requires the consent or notification of the obligors, then such consent or notice is required in order for the assignment to be effective against such obligors. Any set-off rights or other means of defences exercisable by the obligors against the assignee are crystallised or cut-off on the relevant date the assignment becomes effective, (i) regardless of notification when such notice is dispensed as in question 4.2 above, or (ii) upon notification or awareness of the debtor when such is required.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

Under the Securitisation Law, when applicable, notification to the debtor is required to be made by means of a registered letter (to be sent to the debtor’s address included in the relevant receivables contract) and such notification will be deemed to have occurred on the third business day following the date of posting of the registered letter.

An exception to this requirement applies when the assignment of credits is made under the Securitisation Law as described in question 4.2 above.

There is no applicable time limit to the delivery of notice to the obligors, taking into account in any case that, if no exception applies, the assignment shall only be effective towards the obligors upon delivery of the relevant notice. The notice can be delivered after commencement of any insolvency proceedings against the obligor or against the seller, and the contractual documents for securitisation transactions usually include provisions to allow the assignee to be able to notify all the obligors in case the seller/assignor does not do so.
When required, notice of assignment of credits must be given to each obligor, even though notice may be given for future credits.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Portugal? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Portugal recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on assignment existing in the underlying receivables contracts are enforceable in Portugal, even though such contractual prohibitions can only be effective towards the assignee if it were aware of such prohibition on the assignment date, as set out in the Portuguese Civil Code. If a given receivables contract comprises such a contractual prohibition on assignment and nevertheless the seller assigns the receivables to a third party, then the seller will be liable towards the obligor for breach of contract, i.e., wilful default (“incumprimento culposo”) of an obligation, in accordance with the provisions of the Portuguese Civil Code.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The assignment agreement must identify, specifically, the receivables which are being assigned under a given contract, given that the object of the assignment must be determinable in accordance with the Portuguese Civil Code, such usually being done by listing the relevant receivables in a schedule to the assignment agreement. Such list of assigned receivables refers to standard characteristics of the relevant credits, without disclosing personal data of the obligors which would allow their identification, in accordance with the applicable data protection rules. Under the Securitisation Law, bulk assignments are not considered and the seller will not assign all of its undetermined receivables to a given purchaser (or all of its receivables other than a few identified receivables), rather identifying those receivables to be actually assigned and which comply with the Securitisation Law eligibility criteria.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The assignment of the receivables under a receivables sale agreement is generally construed to constitute a valid and true assignment of receivables from an originator to the assignee.

In terms of economic characteristics of an assignment of receivables, we note that the Securitisation Law requires a true and complete assignment, not being subject to any term or condition. Furthermore, neither the originating entity, nor any of its group companies, may provide any guarantees or enhancement in the context of the assignment or undertake responsibility for payments made by the underlying obligors. As such, the seller retaining credit risk, interest rate risk or control of collections (for its own benefit) or a right of repurchase could be seen as colliding with such true sale concept. In what concerns the control of collections, we would note additionally, that where the seller is a credit institution in the context of a securitisation, usually the purchaser mandates such seller to act as servicer of the receivables and ensure receipt of collections from the borrowers on behalf of the purchaser, it being clear however that any amounts so held by the servicer do not pertain to the servicer (even in a servicer event) and rather belong to the purchaser, in accordance with the Securitisation Law. In this sense, an assignment under the Securitisation Law will typically be a perfected assignment. In terms of repurchase, we would note that the seller would typically have an obligation of repurchase in case of hidden defects or false representations and warranties relating to the assets.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Without prejudice to question 4.10 below regarding future receivables, continuous sales would be possible under the Securitisation Law provided they are in compliance with question 4.7 above. However, sellers have rather opted to carry out securitisation transactions with revolving periods for assignment of additional receivables on a periodic basis, against payment out of collections and additional funding by issuance of further notes.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Pursuant to Article 4.3 of the Securitisation Law, future receivables may be assigned for securitisation purposes provided such receivables (i) arise from existing relationships, and (ii) are quantifiable (a confirmation of the estimations made by the originator in respect of the quantum of the future receivables that are being securitised usually being sought). In terms of structure, the originator will assign to the purchaser certain rights over the future receivables, in an amount equivalent to a given overcollateralised percentage of the debt service and the originator will guarantee that the future receivables generated during each collection period will be sufficient to cover the agreed debt service and, accordingly, for each interest period it will transfer to the purchaser an amount equivalent to 100 per cent of the debt service in respect of such interest period. Furthermore, in case the originator is unable to originate sufficient future receivables to meet its obligations for a given interest period, it will, in any event, pay to the purchaser an amount equal to such shortfall of future receivables, in order to ensure an amount equal to 100 per cent of the relevant debt service. In respect of insolvency, we refer to question 6.5 below.
4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Under the Portuguese Civil Code, the general rule is that the assignment of credits also implies the transfer of any kind of security or other form of guarantee, unless the relevant assignment agreement provides otherwise. If certain formalities apply to the creation of security, then such formalities also usually need to be complied with for a valid transfer of security. Please see questions 4.2 and 4.3 regarding the transfer of mortgages under the Securitisation Law and question 5.5.

5 Security Issues

5.1 Back-up Security. Is it customary in Portugal to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Back-up security in the context of the Securitisation Law is not customary in Portugal, considering that noteholders and secured creditors benefit from the legal creditors' privilege set forth in Article 63 of the Securitisation Law, which covers the transactions assets located in and outside of Portugal.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Portugal, and for such security interest to be perfected?

Under Portuguese securitisation transactions, the sellers do not provide security interests to the receivables, given that such could be considered as jeopardising the true sale nature of the transaction.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Portugal to grant and perfect a security interest in purchased receivables governed by the laws of Portugal and the related security?

The purchasers in Portuguese securitisation transactions do not usually provide additional security to the noteholders and secured creditors of a given transaction, given that these entities benefit from the legal creditors’ privilege mentioned in question 5.1 above. Other than obtaining the relevant approval for incorporation of the fund or asset digit code approval from the Portuguese Securities Commission (“CMVM”) which confirms the applicability of the legal creditors’ privilege in respect of a given portfolio of receivables pertaining to certain notes issued, no additional formalities are required in order to perfect such legal creditors’ privilege, given that it is not subject to registration.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Portugal, and such security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Portugal or must additional steps be taken in Portugal?

The security interest would be recognised as valid and effective in Portugal provided that any applicable Portuguese formalities relating to the protection of interested third parties are followed (we refer to question 5.5 below). For instance, it would be possible to grant an English law pledge over Portuguese law receivables, however, the debtor of those receivables should be notified of such security interest in accordance with Portuguese law in order for it to be effective against said debtor.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

In respect of additional formalities for validly creating security interests in respect to assets abovementioned, we note that formalities regarding evidence to third parties must be followed, such as: (a) security over insurance policies needs to be notified to the relevant insurance provider; (b) security over promissory notes needs to be endorsed by the security grantor to the benefit of the security beneficiary on the relevant title; (c) creation of mortgages or subsequent transfers of entitlements in respect thereof need to be registered with the competent registry office; and (d) security in respect of marketable debt securities needs to be registered either in the relevant securities account (in respect of book-entry securities) or in the relevant title and securities register (in respect of physical securities).

5.6 Trusts. Does Portugal recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

In general, Portuguese law does not recognise the legal concept of a trust. However, in terms of collections received by the seller pertaining to a given securitisation transaction, we refer to the segregation principle and autonomous estate nature as set out in question 7.2 below. Furthermore, in respect of collections held by the servicing entity, we would also refer to question 4.8 above.

5.7 Bank Accounts. Does Portugal recognise escrow accounts? Can security be taken over a bank account located in Portugal? If so, what is the typical method? Would courts in Portugal recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Portugal?

Portuguese law does not expressly govern escrow accounts; however, similar types of arrangements can be contractually set up and are commonly used by Portuguese banks. Security interests can be taken over bank accounts in Portugal and the typical method to do so would be by granting a pledge over such bank account. A reference should be made to the form of financial pledges which are the customary method of taking security over bank accounts by financial institutions, financial pledges being governed by the regime of Decree-Law no. 105/2004, dated 8 May 2004, in line with the financial collateral arrangements directive. The important
characteristic of such financial pledges being that the collateral taker may have the possibility to use and dispose of financial collateral provided as the owner of it. English law pledges over Portuguese bank accounts are possible, but the relevant Portuguese bank (as debtor in relation to the balance of that account from time-to-time) should be notified of the granting of the pledge.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The Bank Accounts of the transaction may naturally be subject to security to the benefit of the transaction creditors. No specific or autonomous security is usually required as in fact, Portuguese securitisation transactions have the benefit of a legal special creditor’s privilege (“privilégio creditório especial”) detailed in response to question 7.2 below, which exists in respect of all assets forming part of the portfolio allocated to each transaction related to an issuance of notes (including the transaction bank accounts) and therefore has effect over those assets existing at any given moment in time for the benefit of the STC that are allocated to the relevant issuance of securitisation notes (including the transaction bank accounts). Upon enforcement, the common representative of the noteholders or the trustee will control the cash flowing into the bank accounts on behalf of the secured creditors and noteholders and will ensure that they are repaid in full.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

The Bank Accounts of the transaction may be subject to security to the benefit of the transaction creditors, as set out in question 5.8 above. In such context, the owner of the transaction is the Issuer, the securitisation vehicle and it can access the funds standing to the credit of such accounts subject to security prior to enforcement thereof. However, we would note that the issuer is contractually bound to apply the funds in such accounts exclusively in the manner set out in the transaction documents, i.e., by applying such available funds in accordance with the agreed priorities of payments and such utilisation is monitored by the common representative/trustee.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Portugal’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (“stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

In accordance with Article 6 of the Securitisation Law, the general rule is that the assignment of receivables (described in question 4.2 above) becomes immediately valid and effective between the parties upon the execution of the relevant assignment agreement, irrespective of the debtor’s consent, notification or awareness. This means that the assignment of the receivables under the Securitisation Law constitutes a valid and true assignment of receivables from the seller to the purchaser, namely to the extent that the insolvency of the seller will not cause the sale or assignment to be declared void from a legal stand point and neither any insolvency official, any borrower nor any creditor of the seller would be able to have set aside such assignment unless it could provide evidence as to the fact that the assignment had been made in bad faith (v.d. Article 8 of the Securitisation Law). To set aside the assignment conducted on these terms, this would have to be made either by evidencing, in the context of the insolvency, the parties’ bad faith or, within the period of five years following completion of the sale of the receivables, through an application for an unenforceability judgment (“impugnação pauliana”) of such assignment and only providing the claiming party is capable of proving that: (i) the sale of the receivables has decreased the assets or increased the liabilities of the originator; (ii) the claim of the relevant creditor has arisen before completion of the sale of the receivables (although claims arising after completion of the date of receivables may also be affected to the extent that the relevant creditor provides evidence that such sale has been entered with for the specific purpose of avoiding the payment satisfaction of the creditors’ claim; (iii) completion of the sale of the receivables has caused or worsened the insolvency situation of the originator; and (iv) both the originator and the purchaser acted in bad faith, that is, both of them were aware that completion of the sale of the receivables would have the effect described in subparagraph (iii) above.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Other than as indicated in question 6.3 below, and on the assumption that a true sale is in place, the only means to prohibit the exercise of rights by the purchaser would be through an injunction (providência cautelar não especificada) followed by the competent main court action.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Portugal for (a) transactions between unrelated parties and (b) transactions between related parties?

Acts that may be qualified as detrimental to the insolvent estate, performed within four years prior to the opening of the corporate insolvency proceedings, may be challenged by the insolvency administrator on behalf of the insolvent estate. The relevant acts for this purpose are those that diminish, frustrate, aggravate, put in danger or delay the rights of the debtor’s creditors. These acts can only be challenged if it is proved that they were motivated by the parties’ bad faith (where the counterparty to the act or the beneficiary of the act is a person or entity related to the insolvent entity, the relevant act will be deemed to be motivated by bad faith if carried out within a period of two years prior to the opening of the corporate insololvency proceedings).
The parties’ bad faith is defined as knowledge of any of the following circumstances on the date of the relevant act:

(a) that the debtor was insolvent, i.e., unable to fulfil its obligations as they fall due or the debtor’s liabilities exceed its assets;
(b) that the act was of a detrimental nature and that the debtor was in a situation of imminent insolvency; or
(c) that insolvency proceedings had commenced.

There are certain acts and transactions which are legally deemed to be detrimental to the insolvent company’s estate by themselves without need of any additional proof (such as proof of bad faith of any party). This is the case where:

(a) security was granted within a period of six months prior to the commencement of corporate insolvency proceedings (where such security was granted in respect of pre-existing obligations);
(b) security was granted simultaneously with the secured obligations, within a period of 60 days prior to the commencement of the corporate insolvency proceedings;
(c) gratuitous acts (i.e. those for which the debtor did not receive any consideration) were performed less than two years before the commencement of the corporate insolvency proceedings where the act results in a reduction in the assets of the debtor;
(d) surety; sub-surety, guarantee and credit mandates are given, provided they were issued by the insolvent debtor in the six months preceding the date of the commencement of the corporate insolvency proceedings and do not relate to transactions with any real benefit to the debtor;
(e) payment of debts or the performance of other acts occur, which have the effect of performing obligations (for example, set-off) which would become due after the date on which insolvency proceedings are commenced (if such payment or set-off occurs during the six months before the opening of the corporate insolvency proceedings);
(f) payment of debts or the performance of other acts occur, which have the effect of performing obligations (for example, set-off) during the six months prior to the opening of the corporate insolvency proceedings if such payment or set-off is considered unusual according to standard commercial practices and the creditor was not able to demand payment;
(g) acts are performed by the debtor less than a year before the opening of the corporate insolvency proceedings in which the obligations assumed by the debtor significantly exceed those of the counterparty (i.e. transactions at an undervalue); and
(h) reimbursement of shareholder loans occur, if made in the year that precedes the commencement of the corporate insolvency proceedings.

In any event, it must be noted that, should an assignment of receivables have been made under the Securitisation Law, the burden of proving bad faith is reversed as the assumption that the above typified acts were made in bad faith will not apply. If an assignment of receivables has been made under the Securitisation Law, the relevant interested parties must always prove bad faith in order for the assignment to be declared void.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

This is not applicable in the context of the Securitisation Law.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Portugal, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

If the assignment of future receivables is made under the Securitisation Law then the indications provided under question 6.1 above will also apply and therefore such future receivables will not form part of the insolvency estate of the seller even when they only become due and payable or come into existence after the date of declaration of insolvency of the seller, provided that the requirements for assignment of future receivables as set out in question 4.10 are duly complied with prior to the date of declaration of insolvency of the seller.

In case the assignment is not made under the Securitisation Law and the seller becomes insolvent, then the insolvency official may, at its discretion, choose between executing or not executing the receivables sale agreement as this agreement will be suspended by virtue of the declaration of insolvency.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Portugal establishing a legal framework for securitisation transactions? If so, what are the basics?

Generally, the Securitisation Law provides for: (i) the establishment of a standard and specific securitisation legal framework by regulating the establishment and activity of the securitisation vehicles, the type of credits that may be securitised and the entities who may assign credits for securitisation purposes; (ii) a simplification of the assignment process by providing for specific rules on the assignment of credits; and (iii) the expansion of the class of eligible assets to include mortgage loans by providing for a simplified mechanism of assignment of this type of credits.

A special securitisation tax regime is also in place. It was established through Decree-Law 219/2001 dated 4 August 2011 (as amended from time-to-time) (the “Securitisation Tax Law”).

7.2 Securitisation Entities. Does Portugal have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

A flexibility concern seems to have led to the establishment of two different types of securitisation vehicles, the credit securitisation funds (“FTCs”) and the credit securitisation companies (“STCs”).

The FTC structure is necessarily a tripartite one - (a) the Fund which must be managed by a (b) Fund Manager, pursuant to the terms of the applicable fund regulation and one sole (c) Depository, qualifying as a credit institution, must hold the assets of the Fund. Fund Managers (“Sociedade Gestora”), are financial companies who are required to: (i) hold registered offices and effective management in Portugal; (ii) qualify as a sociedade anónima (public limited liability company) whose share capital is represented by nominative or registered bearer shares; (iii) be
exclusively engaged in the management of one or more funds on behalf of the holders of Securitisation Units; and (iv) include in its name the expression “SGFTC”.

As Fund Managers are financial companies, their incorporation is subject to approval by the Bank of Portugal and their activity is generally subject to supervision by this regulatory authority.

One same Fund Manager may have a number of different funds under management and it is the Fund Manager who is responsible for the application for approval of incorporation of each new fund, by filing the relevant approval request with the CMVM - the entity responsible for approving the incorporation of each new fund through the approval of the relevant fund regulation. The incorporation of a fund is deemed to occur upon payment of the subscription price for the relevant securitisation units, something that may only occur upon CMVM’s approval having been obtained.

As the FTC itself has no legal personality (it is an autonomous pools of assets held jointly by a different number of entities), its management is entrusted to the Fund Manager who must manage the fund in accordance with the fund regulation and with certain legal limitations on the management of the FTC such as, for example, the requirement that the funds’ funds are used for the initial or subsequent acquisition of credits (for securitisation purposes) and that such credits represent at least 75 per cent of the securitisation funds’ assets.

Of relevant notice is also the fact that fund managers are subject to specific capital adequacy requirements. A minimum share capital requirement of Euro 250,000 applies while they must have own funds which are equal to, or higher than, a certain percentage of the net value of all funds managed: up to Euro 75 million – 0.5 per cent, in excess of Euro 75 million – 0.1 per cent.

Securitisation companies are companies who are required to: (i) qualify as a sociedade anónima (public limited liability company) whose share capital is represented by nominative shares; (ii) include in its name the expression “STC”; and (iii) be exclusively engaged in the carrying out of securitisation transactions by means of acquiring, managing and transferring receivables and of issuing notes as a source of financing such acquisitions.

The incorporation of STCs is subject to an approval process near the CMVM and, although they do not qualify as financial companies, this process imposes compliance with a number of requirements that are similar to those arising under all relevant Banking Law requirements. These requirements may be said to have an impact in terms of the shareholding structure an STC is to have to the extent that full disclosure of both direct and indirect ownership is required for the purposes of allowing the CMVM to assess the reliability and soundness of the relevant shareholding structure. The same applies in respect of the members of corporate bodies, namely directors who must be persons whose reliability and availability must ensure the capacity to run the STC business in a sound and prudent manner.

STCs are also subject to specific capital adequacy requirements. A minimum share capital requirement of Euro 250,000 applies while they must have own funds which are equal to, or higher than, a certain percentage of the net value of all funds managed: up to Euro 75 million – 0.5 per cent; and in excess of Euro 75 million – 0.1 per cent.

In terms of legal attributes and benefits, we believe it is fair to say that both vehicles are quite similar as they both allow for a full segregation of the relevant portfolios and their full dedication to the issued securities. While in a fund structure this is achieved through the structure itself, as the assets of each fund are only available to meet the liabilities of such fund in a company structure, certain relevant legal provisions establish a full segregation principle and a creditors’ privileged entitlement over the assets that are so segregated and which collateralise a certain issue of notes.

This segregation principle means that the receivables and other related assets and amounts existing at a given moment for the benefit of an STC, and which are related to a certain issuance of notes, constitute an autonomous and ring-fenced pool of assets (“património autónomo”) which is exclusively allocated to such issuance of notes and which is not, therefore, available to creditors of the STC other than the noteholders, and to the services providers existing specifically in the context of such issuance of notes until all the amounts due in respect of the notes have been repaid in full. To this effect, the assets integrated in each património autónomo are listed and filed with the CMVM and subject to an asset identification code that is also granted by the CMVM.

In addition to the above, and in order to render this segregation principle effective, the noteholders and the other creditors relating to each series of securitisation notes issued by the STC are further entitled to a legal creditor’s privilege (equivalent to a security interest) over all of the assets allocated to the relevant issuance of securitisation notes, including assets located outside Portugal. In fact, according to Article 63 of the Securitisation Law, this legal special creditor’s privilege (“privilégio creditório especial”) exists in respect of all assets forming part of the portfolio allocated to each transaction related to an issuance of notes and therefore has effect over those assets existing at any given moment in time for the benefit of the STC that are allocated to the relevant issuance of securitisation notes.

Limited recourse provisions are valid and binding under Portuguese law, deriving directly from the provisions of Articles 60 et seq. of the Securitisation Law. Insofar as limited recourse arrangements are concerned, we would furthermore take the view that they correspond to an application in a specific context (that of securitisation) of a possibility of having a contractual limitation on the assets which are liable for certain obligations or debts, which is provided for by Portuguese law on general terms (see Article 602 of the Portuguese Civil Code). Once they result from the quoted provisions of the law, limited recourse shall not be affected by the issuer’s insolvency, however remote, such event may be in the context of the Portuguese securitisation vehicles.

Non petition, limited recourse and priority of payments arrangements, as usually contained in the securitisation transactions documentation are valid under Portuguese law, deriving directly from the provisions of Articles 60 et seq. of the Securitisation Law.

Priority of payments provisions are standard contractual provisions included in Portuguese securitisation transactions (both governed by Portuguese law; when the vehicle is a securitisation company
and governed by a foreign law, usually English law, when the vehicle at stake is a securitisation fund, as in this case, the Issuer is usually an Irish SPV) and are valid under Portuguese law and would be given effect by a Portuguese court (but if governed by a foreign law in the context of a judicial recognition of a foreign court decision – reconhecimento de sentença estrangeira).

7.6 Independent Director. Will a court in Portugal give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

As per the Portuguese Insolvency Code, the commencement of insolvency proceedings is an obligation of the board of directors of any given company that is found to be insolvent and therefore there should not be a limitation as to the fulfilment of this legal obligation.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Portugal, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Portugal? Does the answer to the preceding question change if the purchaser does business with other sellers in Portugal?

The mere purchase and management of a certain portfolio of receivables does not in itself qualify as a banking or financial activity (unless it is to be carried out on a professional and regular basis) as should therefore not give rise to the need for any kind of authorisation or licence being obtained.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

No. When the seller remains in charge of the collection of receivables (as, in fact, is foreseen in the Securitisation Law for example when the seller is a bank) no licence or authorisation is required for the seller to continue to enforce and collect receivables, including to appear before a court (assuming the debtors are not aware of the assignment). However, should the assignment of the receivables have been notified to the debtors then the servicer will need to show sufficient title to appear in court, like a power of attorney, in case its legitimacy is challenged by the relevant debtor as, in fact, only a fully-fledged creditor has the relevant legitimacy (legitimaude processual) to claim a certain credit in court.

In case a third party replacement servicer is appointed to replace the seller as original servicer or a back-up servicer is required to be put in place, CMVM’s approval to this effect is required whenever the seller is a credit institution, a financial company, an insurance company, a pension fund or a pension fund manager (as in these cases the law actually imposes that the seller remains as servicer). When the seller is not one of any of the above types of entities, any third party may take on the servicing role, provided it is a reliable entity for the purposes of the Securitisation Law and it is approved by the CMVM.

8.3 Data Protection. Does Portugal have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

There are, indeed, applicable data protection laws but which exclusively in respect of consumer obligors or individuals and not to enterprises. However, the use or dissemination of personal data in respect of directors of enterprises who are individuals will also be subject to restrictions.

Law no. 67/98 of 26 October 1998, (the “Data Protection Law”), which implemented Directive 95/46/EC, of 24 October 1995, provides for the protection of individuals regarding the processing and transfer of personal data.

Pursuant to the Data Protection Law, any processing of personal data requires express consent from the data subject, unless the processing is necessary in certain specific circumstances as provided under the relevant laws.

The entity collecting and processing personal data must obtain prior authorisation from the Comissão Nacional de Protecção de Dados (the “CNPD”), the Portuguese Data Protection Authority, before processing such data.

Transfer of personal data to an entity within a Member State does not require authorisation by the CNPD but must be notified to the relevant data subjects.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Portugal? Briefly, what is required?

Portuguese law (namely the Portuguese Constitution, the Civil Code and the Consumer Protection Law) contains general provisions in relation to consumer protection. These provisions cover general principles of information disclosure, information transparency (contractual clauses must be clear, precise and legible) and a general duty of diligence, neutrality and good faith in the negotiation of contracts.

Decree Law no. 446/85, dated 25 October 1985, as amended by Decree Law no. 220/95, dated 31 July 1995 and Decree Law no. 249/99, dated 7 July 1999 (which implemented Directive 93/13/CE of 5 April 1993) and Decree Law no. 323/2001, dated 17 December 2001 known as the Lei des Cláusulas Contratuais Gerais (the Law of General Contractual Clauses) prohibits, in general terms, the introduction of abusive clauses in contracts entered into with consumers. Pursuant to this law, a clause is deemed to be abusive if such clause has not been specifically negotiated by the parties and leads to an unbalanced situation insofar as the rights and obligations of the consumer (regarded as the weaker party) and the rights and obligations of the counterparty (regarded as the stronger party) are concerned and the law provides for an extended list of prohibited clauses. The use of such clauses that are prohibited will cause the relevant clauses to be considered null and void.

Decree Law no. 220/94, dated of 23 August 1994 states the minimum level of information to be included in loans, such as the annual effective.
8.5 Currency Restrictions. Does Portugal have laws restricting the exchange of Portugal's currency for other currencies or the making of payments in Portugal's currency to persons outside the country?

Other than in international embargo circumstances, there are no laws in Portugal restricting foreign exchange transactions or free international capital movements.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligor or the purchaser be subject to withholding taxes in Portugal? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

The Securitisation Tax Law has established the tax regime applicable to the securitisation transactions carried out under the Securitisation Law. Its main goal was to ensure a tax neutral treatment to the securitisation transactions set up by each one of the securitisation vehicles provided for in the Securitisation Law. Therefore, under Articles 2(5) and 3(4) of the Securitisation Tax Law, there is no withholding tax on (i) the payments made by the purchaser (either an STC or an FTC) to the seller in respect of the purchase of the receivables, (ii) the payments by the obligors under the loans, and (iii) the payments of collections by the servicer (who usually is also the seller) to the purchaser are not subject to Portuguese withholding tax. The nature or the characteristics of the receivables and the location of the seller do not have any influence on the tax regime referred to above. However the purchaser must be an STC or an FTC resident for tax purposes in Portugal in order to benefit from the special tax regime.

On the other hand, payments of interest and principal in respect of receivables and the location of the seller do not have any influence on the tax regime referred to above. However the purchaser must be an STC or an FTC resident for tax purposes in Portugal in order to benefit from the special tax regime.

9.2 Seller Tax Accounting. Does Portugal require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No specific tax accounting requirements need to be complied with by the seller under the securitisation regime. However, the CMVM Regulation no. 1/2002, dated 5 February 2002, sets forth the specific accountancy regime for the FTC, and the CMVM Regulation no. 12/2002, dated 18 July 2002, establishes specific accountancy rules for the STC (although the accounting procedure of this type of corporate entity follows the general Portuguese Accountancy Standards).

9.3 Stamp Duty, etc. Does Portugal impose stamp duty or other documentary taxes on sales of receivables?

Pursuant to the Securitisation Tax Regime, no stamp duty is due on: (i) the sale of receivables being securitised; or (ii) the fees and commissions which fall under Article 5 (i.e. referring to acts necessary to ensure a good management of the receivables and, if applicable, of the respective guarantees, and to ensure collection services, the administrative services relating to the receivables, all relations with the debtors and also maintaining, modifying and extinguishing acts related to guarantees, if any) and under Article 24 (i.e. referring to any of the described attributions of the depositary), both of the Securitisation Law, that may be charged by the servicer to the purchaser. In addition, no documentary taxes are due in Portugal.

9.4 Value Added Taxes. Does Portugal impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The sale of receivables is VAT exempt under Articles 9(27)(a) and (c) of the Portuguese VAT Code, which are in line with Article 135(a) and (c) of the VAT Directive (EC Directive 2006/112/EC). Pursuant to the Securitisation Tax Regime, no Value Added Tax is due on the administration or management of securitisation funds and also on the fees and commissions regarding management services which fall under Article 5 and transactions undertaken by depositary entities pursuant to Article 24 of the Securitisation Law, as described in question 9.3 above.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

This is not applicable since the assignment of the receivables benefits from a stamp tax and a VAT exemption.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Portugal, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Portugal?

Considering the above, it is important to highlight that the purchase of the receivables is qualified as a true sale transaction under the Securitisation Law, the purchaser being the legal owner of the receivables and therefore the purchaser is subject to tax in Portugal (namely in respect of income arising from the receivables). However, despite being viewed as an ordinary taxpayer, in order to ensure a tax neutral treatment on the securitisation transactions, the taxable income of the purchaser tends to be equivalent to zero for tax purposes since the income payments made to the note holders/unitholders are tax deductible.
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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

In theory, a contract could be deemed to exist as a result of the behaviour of the parties and/or with the provision of evidence in the form of invoices. Oral contracts are a recognised form of contractual agreement in Saudi Arabia. Nevertheless, this approach is not advisable as the interpretation of a contract, which is not evidenced in writing, will be left to the discretion of the relevant adjudicating system. In the absence of the concept of precedent, each dispute is decided on its individual merits, which is unpredictable. Any assignment of receivables needs to be executed by all three parties, the obligor, obligee and original party. In order to avoid a claim that the signature was fraudulently obtained, a contract should be executed and witnessed by two Muslim males.

1.2 Consumer Protections. Do Saudi Arabia’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Under the Shari’ah, which is the paramount body of law in Saudi Arabia, the charging and payment of interest are prohibited; in light of this, questions 1.2(a) and 1.2(b) above are not applicable. In respect of questions 1.2(c) and (d) above, there is no specific applicable consumer protection legislation in Saudi Arabia, but the Ministry of Commerce and Industry does advise businesses to follow some basic consumer protection guidelines, which in themselves are guidelines and not enforceable.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

In an agreement with a governmental entity, a governmental entity will require that such contract is governed by Saudi Arabian laws and regulations, that the agreement is in Arabic and that any dispute will be heard by the local courts rather than arbitration in, or outside, of Saudi Arabia.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Saudi Arabia that will determine the governing law of the contract?

If no law is specified, the assumption is that the laws and regulations of Saudi Arabia apply.

2.2 Base Case. If the seller and the obligor are both resident in Saudi Arabia, and the transactions giving rise to the receivables and the payment of the receivables take place in Saudi Arabia, and the seller and the obligor choose the law of Saudi Arabia to govern the receivables contract, is there any reason why a court in Saudi Arabia would not give effect to their choice of law?

It is difficult to envision a scenario where a court in Saudi Arabia would not give effect to the fact that both parties are resident in Saudi Arabia, the contract is governed by the laws of Saudi Arabia and the contract relates to the payment of receivables in Saudi Arabia.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Saudi Arabia but the obligor is not, or if the obligor is resident in Saudi Arabia but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Saudi Arabia give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such that between the seller and the obligor under the receivables contract?

Saudi Arabia follows the Shari’ah and more importantly the Hanbali School/Guild which generally permits freedom of contract to the extent such does not violate the Shari’ah or a specific Saudi law. Saudi courts and other adjudicatory authorities do not traditionally recognise the choice of foreign law regardless of whether one of the parties is not resident in Saudi Arabia. With respect to the enforcement of foreign law judgments, the Board of Grievances would ordinarily require that the party seeking
recognition demonstrate: (i) either that Saudi Arabia and the relevant foreign law jurisdiction are parties to a bilateral or multilateral agreement for the reciprocal interpretation or enforcement of judgments or, in the absence of such agreement, that such country would recognise and enforce a Saudi judgment in the same manner as a domestic judgment; (ii) that the Saudi judgment debtor was accorded due process in the foreign proceeding, including due notice and the opportunity to appear in and defend itself in such proceeding; (iii) that such foreign judgment is final in the country where it was issued; and (iv) that such foreign judgment contains nothing that contravenes the Shari’ah or the public policy of Saudi Arabia.

With the exception of judgments issued by the courts of Arab League and GCC countries (that are subject to the 1983 Convention on Judicial Co-operation between States of the Arab League (the Riyadh Convention)), Saudi courts are not likely to recognise foreign judgments. However, in our experience, for example, we are aware of Bahraini and other GCC judgments (and arbitral awards) being enforced in Saudi Arabia, but not any non-GCC foreign judgments (arbitral awards).

3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Do Saudi Arabia’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Saudi Arabia’s laws or foreign laws)?

In effect, the laws of Saudi Arabia do require the sale of receivables to be governed by the same law as the law governing the receivables themselves, as the Saudi courts and other adjudicatory authorities do not traditionally recognise the choice of foreign law regardless of whether the sale contract or the receivables themselves are governed by foreign law.

3.2 Example 1: If (a) the seller and the obligor are located in Saudi Arabia, (b) the receivable is governed by the law of Saudi Arabia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Saudi Arabia to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Saudi Arabia, will a court in Saudi Arabia recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller)?

If both the receivables and the purchase agreement are governed by the laws of Saudi Arabia, then the Saudi courts will recognise the choice law and apply Saudi law exclusively. If all formalities have been adhered to, and the sale complies with local law requirements, then the sale, in theory, should be recognised as being effective against the seller, the obligor and other third parties.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Saudi Arabia, will a court in Saudi Arabia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

If the receivables and the purchase contract are governed by the laws of Saudi Arabia, then the location of one of the parties outside of Saudi Arabia is irrelevant. Saudi courts and other adjudicatory authorities will interpret the sale from a Saudi law perspective and apply Saudi law exclusively. Adherence to foreign law requirements of the parties based outside Saudi Arabia will not be taken into account unless such requirements are compatible with the laws of Saudi Arabia.

If all formalities have been adhered to and the sale complies with local law requirements, then the sale, in theory, should be recognised as being effective against the seller and other third parties.

3.4 Example 3: If (a) the seller is located in Saudi Arabia but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Saudi Arabia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Saudi Arabia’s own sale requirements?

As previously mentioned, Saudi courts and other adjudicatory authorities do not recognise the choice of foreign law. Regardless of whether the sale complies with the requirements of the obligor’s country, there is no guarantee that such sale will be recognised as being effective under the laws of Saudi Arabia. The Saudi courts will consider the sale from a Saudi law perspective. In circumstances where a judgment has been enforced in the obligor’s and purchaser’s country in respect of the sale, the ability of the obligor to enforce a foreign judgment will be subject to the discretion of the Board of Grievances. The parameters as to how they exercise their discretion were outlined above in question 2.3.

3.5 Example 4: If (a) the obligor is located in Saudi Arabia but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Saudi Arabia recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Saudi Arabia’s own sale requirements?

Saudi courts and other adjudicatory authorities do not recognise the choice of foreign law. Regardless of whether the sale complies with the requirements of the seller’s country, there is no guarantee that such sale will be recognised as being effective under the laws of Saudi Arabia. The Saudi courts will consider the sale from a Saudi law perspective. In circumstances where a judgment has been enforced in the seller’s country in respect of the sale, and despite Saudi Arabia being a
3.6 Example 5: If (a) the seller is located in Saudi Arabia (irrespective of the obligor’s location), (b) the receivable is governed by the law of Saudi Arabia, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Saudi Arabia recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Saudi Arabia and any third party creditor or insolvency administrator of any such obligor)?

In this instance the seller’s country is Saudi Arabia and the receivables are governed by Saudi Arabia, as such the receivables will be interpreted in line with the laws of Saudi Arabia and so would have to comply with the requirements of Saudi Arabia. The purchase contract itself would be interpreted in line with the laws of Saudi Arabia as Saudi courts do not recognise the choice of foreign laws.

If the sale complied with the requirements of the purchaser’s country, this would be relevant in so far as such sale was consistent with Saudi Arabia’s own sale requirements. This would also be the case when determining if the sale is effective against the seller. In circumstances where the purchaser, based in another jurisdiction, is able to demonstrate that the sale is effective in his/her own jurisdiction and is awarded a judgment to that effect, it will be up to the purchaser to demonstrate in front of the Board of Grievances that such judgment is transferable and should be awarded in Saudi Arabia.

4.1 Sale Methods Generally. In Saudi Arabia what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

The most common method would be a three party assignment of the receivables. For purposes of a Shari’ah-compliant sukuk and receivables thereunder, there is normally only a sale contractually rather than a true sale of property. In terms of Shari’ah a “sale” of receivables does not require notice as the asset has been sold. While correct from a Shari’ah point of view, such likely still requires a three party assignment to be enforceable before the local courts. For most sukuk, the receivables should reflect at least 35 per cent of the assets be true tangible assets rather than simply a sale of receivables.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

For perfection to take place in Saudi Arabia, it is a principle of the Shari’ah that “everything is possessed in accordance with its nature”. There are no clear definitions under the laws and regulations of Saudi Arabia of what actually constitutes “possession” for this purpose. The Hanbali school takes the position that actual possession and control is required as a prerequisite for perfection to occur. As discussed below, there are few methods to perfect security under current Saudi law. Relatively new is the Unified Centre for Lien Registration established pursuant to Ministerial Resolution No. 1812/1/8/267 dated 19/2/1423H and operating under the aegis of the Saudi Arabian General Investment Authority. Promptly following execution of any agreement requires registration of the security interest. While such is being used for movables, we are not aware of such being used for assignment of receivables but understand such is being reviewed.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Promissory notes should be obtained separately for each obligation (e.g. in the case of a loan - the principal and profit payments) so as to avoid any question of invalidating the note. In Saudi Arabia ‘payable on demand’ promissory notes are only valid for a period of 12 Hijri months. Therefore loan documentation should also be drafted to provide for replacement notes to be issued every 11 months. The failure to supply such replacement notes should also constitute an event of default. Normally, separate promissory notes are provided for the principal versus the profit/interest portion.

Under the Shari’ah, a mortgage is not validly created unless transfer from the mortgagee to the mortgagee of actual possession and control of the collateral occurs. If any collateral is not transferred to the actual possession of the mortgagee, the mortgage or pledge would be incomplete and revocable with respect to such collateral.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

In order to give effect to a sale of receivables and for such sale to be effective, the obligor must be issued with notice and provide the seller and/or purchaser with an acknowledgment of such notice accepting the terms and conditions of the sale. This acknowledgment must then be returned to the purchaser. The answer is also dependant upon the underlying agreement in respect of the receivables. If the receivables contract is silent then it is customary for notice to be provided as a means to achieve assumed compliance, enforceability and good customer relations. If the receivables contract expressly prohibits an assignment, then such a prohibition can only be circumvented with the express permission of the obligors.
4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective—e.g., for contracts between commercial entities? If Saudi Arabia recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

This will depend entirely upon the notice provisions of the underlying receivables, there is no legislation pertaining to notice mechanics in Saudi Arabia.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Saudi Arabia? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Saudi Arabia recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Assignments are very much a feature of commercial agreements in the Saudi market.

In order to give effect to an assignment of contract receivables, an assignment agreement must be put in place. The standard approach under Saudi law is to have a three-party agreement or a fairly basic assignment agreement executed and a notice then sent to the third party, requesting that a fairly detailed written acknowledgment accepting the terms and conditions of the assignment be returned addressed to the new beneficiary. Preferably there is a three-party agreement.

An assignment implemented along these lines would give rise to a contractual obligation requiring the third party to fulfil his/her contractual obligations. In the event that the third party does not honour his/her agreement and pays the previous beneficiary rather than the assignee, the assignee should have a claim against the third-party.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Each receivable being sold should be documented with all available information pertaining to the relevant receivable. Needless to say, this will largely depend upon the nature of the receivables contract itself. For a sale to be effected, it must be possible to definitively determine the exact assets which are being sold.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables without jeopardising perfection; or (d) a right of purchase/redemption without jeopardising perfection?

As previously mentioned, in the absence of the concept of precedent, each dispute is decided on its individual merits as there is no case law from which to take definitive guidance. To the extent that the parties have denominate the transaction as a sale and clearly stated their intentions in the agreement, the only determination of the court would be as to whether the contract adheres to local law requirements.

If elements of the contract are unclear or the contract has not adhered to the requirements of Saudi Arabia, it is more likely that the economic characteristics of the transaction will be examined more closely.

In respect to the retention of control, this is not possible for the seller as under the laws of Saudi Arabia, the sale must constitute a true sale and a divestment of the seller’s interest.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Continuous sales of receivables as, and when, they arise are not possible in Saudi Arabia as such a sale is not arguably Shari’ah-compliant. Shari’ah requires that, for an asset to be sold, the seller must have a right, title or interest in the asset at the time of sale.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Future sales of receivables as, and when, they arise are arguably not possible in Saudi Arabia as such a sale is not Shari’ah-compliant. Shari’ah requires that, for an asset to be sold, the seller must be in possession of the asset at the time of sale. However, it is common to assign receivables that are to be received as a matter of practice.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Both the security and the receivables must pass concurrently, however it should be noted that this will depend on the nature of the underlying receivables.

There are currently very limited codified regulations in Saudi Arabia governing secured transactions or mortgages, pledges and assignments, and the ability to create a legal, valid, binding and enforceable security interest is limited.
5 Security Issues

5.1 Back-up Security. Is it customary in Saudi Arabia to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

This will be transaction-specific and dependent upon the credit analysis of the transaction, as well as the legal opinion if, or where, relevant.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Saudi Arabia, and for such security interest to be perfected?

Any security taken in Saudi Arabia will have to adhere to the Commercial Mortgage Regulations established under Royal Decree No. M/75 dated 21/11/1424H (corresponding to 27 February 2004G) and supplemented by the implementing regulations issued by the Minister of Commerce and Industry, Decision No. 6320 dated 18/6/1425H (published in Umm Al Qura edition No. 4016 dated 29 October 2004).

The commercial mortgage regulations establish a statutory framework applicable to mortgages and pledges over movable property. However, the extent to which the Commercial Mortgage Regulations apply in practice, and the procedures required of a person seeking to comply with the Commercial Mortgage Regulations in order to perfect security, is not yet in effect.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Saudi Arabia to grant and perfect a security interest in purchased receivables governed by the laws of Saudi Arabia and the related security?

Please see question 5.2 above.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Saudi Arabia, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Saudi Arabia or must additional steps be taken in Saudi Arabia?

Please refer to question 2.3 in relation to the interpretation of foreign law in Saudi Arabia.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Security interests against pledged collateral can only be enforced after obtaining an order from the Board Grievances. To do so, the lender would apply to the Board of Grievances to sell all or part of the pledged collateral, after having given the pledger-debtor three business days’ notice to pay amounts due and owing. The order of the Board of Grievances may only be executed five days after the Board of Grievances notifies the debtor-pledgor of the place, date and time of the public auction sale. The Commercial Pledge Regulations also contemplate circumstances where an application may be made for an immediate sale (such as when the pledged assets may be likely to be destroyed, or are very costly to maintain).

5.6 Trusts. Does Saudi Arabia recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Saudi Arabia does not recognise common law trusts and the concept of a security trustee, as such, does not exist in Saudi Arabia. Under the Shari’ah, however, the concept of an “adl” (a trustee-arbitrator) or agency does exist, and there is some overlap between the concept of a “security trustee” and that of an “adl”.

In light of the above, an “adl” can be used as a security agent in certain Shari’ah-compliant structured transactions in Saudi Arabia rather than using a security trustee.

5.7 Bank Accounts. Does Saudi Arabia recognise escrow accounts? Can security be taken over a bank account located in Saudi Arabia? If so, what is the typical method? Would courts in Saudi Arabia recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Saudi Arabia?

Saudi law generally upholds pledge/retention agreements related to bank accounts. From a practical viewpoint, lenders in the Saudi market tend to rely heavily on flow-through accounts that would be pledged in their favour and include a right of set-off. Note there is not the possibility of a floating pledge of a bank account. The relevant documentation must make it clear that the lender will have a right of set-off over the relevant account, since such a right must be created contractually as a matter of Saudi law.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full or are there limitations? If there are limitations, what are they?

Saudi law does not allow floating pledges but does permit a bank to have a set-off right against all amounts in such account. The set-off, however, could be challenged and the bank being an unsecured creditor.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

It is arguably possible to have a fixed security over a set amount, but if the owner of the account has access then there is no security as there is no such thing as a floating pledge in Saudi Arabia.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Saudi Arabia’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Liquidation of companies is dealt with briefly under certain provisions of the Saudi Companies Law. However, these provisions do not address a number of issues that arise in relation to the bankruptcy of companies, and tend to focus on voluntary liquidation. Bankruptcy under Islamic law focuses more on personal rather than corporate bankruptcy and several of its provisions are difficult to interpret definitively. Accordingly, it is unclear to what extent the CCR bankruptcy provisions would be applied by a Saudi court (and whether such provisions would be applied to a corporate entity). In the limited cases where bankruptcy proceedings have been filed under the CCR, it appears that the courts have relied primarily on Islamic law principles of fairness.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Please see question 6.1 above.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Saudi Arabia for (a) transactions between unrelated parties and (b) transactions between related parties?

The laws of Saudi Arabia do not make any reference to “suspect periods”, however a Saudi court may set aside a disposal or the grant of a security interest that it considers to be fraudulent.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Please see question 6.1 above.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceeding are commenced against the seller in Saudi Arabia, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Please see question 6.1 above.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Saudi Arabia establishing a legal framework for securitisation transactions? If so, what are the basics?

The securitisations market in Saudi Arabia is in its very early stages. The legislation governing securitisations would be the Capital Markets Law and such securitisations would be regulated by the CMA.

7.2 Securitisation Entities. Does Saudi Arabia have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no special purpose entities for a securitisation.

7.3 Non-Recourse Clause. Will a court in Saudi Arabia give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

It is impossible to determine the court’s interpretation of a non-recourse clause, as this has not yet been tested in Saudi Arabia.

7.4 Non-Petition Clause. Will a court in Saudi Arabia give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

It is impossible to determine the court’s interpretation of a non-petition clause, as this has not yet been tested in Saudi Arabia.

7.5 Priority of Payments “Waterfall”. Will a court in Saudi Arabia give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

No, a local court will likely ignore such provision and utilise Saudi Arabian law.

7.6 Independent Director. Will a court in Saudi Arabia give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

It is impossible to determine the court’s interpretation as this has not yet been tested in Saudi Arabia.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Saudi Arabia, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Saudi Arabia? Does the answer to the preceding question change if the purchaser does business with other sellers in Saudi Arabia?

Any entity which is involved in the purchase, ownership or collection of receivables in Saudi Arabia with a view to securitisation must be licensed to do so by the CMA. The entity will also be regulated in its activities by the CMA. If the purchaser does business with or via other sellers in Saudi Arabia rather than directly purchasing, owning and collecting the receivables, then these sellers must be appropriately licensed and authorised by the CMA to participate in such activities.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Any entity which is involved in the servicing of receivables in Saudi Arabia as part of a securitisation must also be licensed to do so by the CMA. A third party replacement must be also appropriately licensed and authorised by the CMA to participate in such activities. There is a relatively new Saudi mortgage law and expected that the implementing regulations may address this issue.

8.3 Data Protection. Does Saudi Arabia have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Saudi Arabia restricts data that may be held outside of Saudi Arabia. Any data collected should be at the express written consent of the concerned person or party. All data should be held for 10 Hijri years.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Saudi Arabia? Briefly, what is required?

There is no official consumer protection legislation in Saudi Arabia but the Ministry of Commerce does advise businesses to follow some basic consumer protection guidelines, which in themselves are not enforceable.

8.5 Currency Restrictions. Does Saudi Arabia have laws restricting the exchange of Saudi Arabia’s currency for other currencies or the making of payments in Saudi currency to persons outside the country?

There are currently no currency restrictions in Saudi Arabia, except in relation to Israeli Shekels, restricting the exchange of currency for other currencies.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Saudi Arabia? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments by a company or individual from a source in Saudi Arabia to a non-resident of Saudi Arabia are subject to withholding tax of between 5 per cent and 20 per cent depending on the nature of the business.

The withholding tax does not apply to payments made on contracts for goods, but does apply to payments made for services, and at the rate of 5 per cent on interest payments under loan agreements.

9.2 Seller Tax Accounting. Does Saudi Arabia require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

All accounting matters in Saudi Arabia are monitored by SOCPA who set the rules and regulations for GAAP of Saudi Arabia. All companies in Saudi Arabia are required to comply with GAAP of Saudi Arabia. Standards set by the government are through the MOCI, and the accounting standards issued by SOCPA.

9.3 Stamp Duty, etc. Does Saudi Arabia impose stamp duty or other documentary taxes on sales of receivables?

Taxation in Saudi Arabia is administered and regulated by the DZIT and governed by the Income Tax regulations issued pursuant to Royal Decree No. M/1 dated 15/1/1425H.

There is no stamp duty in Saudi Arabia, however Zakat is payable by entities incorporated in Saudi Arabia that are wholly owned by Saudi or GCC nationals. The computation of Zakat is complicated, but it is essentially an assessment of 2.5 per cent of the net wealth of the relevant entity.

If there is a sale of receivables, payments by a company or individual from a source in Saudi Arabia to a non-resident based outside of Saudi Arabia will be subject to withholding tax.

9.4 Value Added Taxes. Does Saudi Arabia impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

There are no value added taxes in Saudi Arabia. Please see question 9.3 above in relation to Zakat for income taxation.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

There are no value added taxes or stamp duties in Saudi Arabia.
9.6 Doing Business. Assuming that the purchaser conducts no other business in Saudi Arabia, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Saudi Arabia?

This will largely depend on the location of the purchaser and the extent of its activities. If the purchaser is based in Saudi Arabia and receives proceeds from the servicer and collection agent or from the enforcement against the obligors then this income stream is likely to be subject to Zakat.

If the purchaser is not based in Saudi Arabia and receives proceeds from the servicer and collection agent or from the enforcement against the obligors then this income stream, if repatriated to the purchaser from Saudi Arabia is likely to be subject to withholding tax.
Chapter 34

Scotland

Brodies LLP

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

It is generally not necessary for the sale of goods or services to be evidenced by a formal receivables contract. Certain types of contract are required to be in writing in order to be binding between the parties, including certain regulated consumer credit arrangements. An invoice in conjunction with the actings of the parties may be sufficient to establish a contract between the parties and evidence a debt.

1.2 Consumer Protections. Do Scotland’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

In consumer credit arrangements, there are statutory restrictions which may affect interest chargeable. Excessive interest could be challenged if, prior to 6 April 2007, it constituted an extortionate credit transaction under s.137 of the Consumer Credit Act 1974 (the CCA) and from 6 April 2007 it constituted an unfair relationship under s.140A of the CCA. Default interest provisions which are penalties may be unenforceable. Certain provisions in consumer contracts may be unenforceable as being unfair under the Unfair Terms in Consumer Contracts Regulations 1999.

The Late Payment of Commercial Debts (Interest) Act 1998 provides for payment of interest in commercial transactions where the parties have not specified that interest is payable following late payment under the contract. The Act applies to commercial contracts for the sale of goods and services but does not apply to consumer contracts.

The CCA contains consumer protections regarding certain forms of consumer credit arrangement including the ability for the consumer to cancel receivables contracts within a specified period of time.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

With the exception of potential immunity issues associated with state entities, there are no different requirements and laws applicable to the sale or collection of receivables from the government or government agencies in Scotland.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Scotland that will determine the governing law of the contract?


Under the Rome Convention, in the absence of an express choice of law, the principle of closest connection is applied in determining the law of the contract. Closest connection is presumed to be the country where a party who is to effect the performance of the contract has its habitual residence (or equivalent), unless the contract is entered into in the course of a party’s trade or profession in which case the closest connection is presumed to be the country in which the party’s principal business is located or if performance is in another place of business, the country where that other place of business is located.

Under the Rome I Regulation, the position is similar, save that habitual residence is a fixed rule with exceptions for particular contract classes where specific rules apply. If, however, it is clear that the contract is more closely connected with the law of a different country, the law of that country is the applicable law.

To the extent the relevant contract is outwith the scope of the 1990 Act or the Rome I Regulation, Scots common law will determine the choice of law where the contract is silent. Scots common law applies the ‘proper law’ to the contract being the law which the parties intended or may fairly be presumed to have intended to invoke in creating the contractual relationship.
2.2 Base Case. If the seller and the obligor are both resident in Scotland, and the transactions giving rise to the receivables and the payment of the receivables take place in Scotland, and the seller and the obligor choose the law of Scotland to govern the receivables contract, is there any reason why a court in Scotland would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Scotland but the obligor is not, or if the obligor is resident in Scotland but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Scotland give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

The parties may expressly choose the governing law relating to the contract and such choice will be recognised by the Scottish courts under certain exceptions specified under the 1990 Act or the Rome I Regulation. For contracts outwith the scope of the 1990 Act or the Rome I Regulation, the Scottish courts are likely, subject to issues of public policy, to recognise the express choice of law of the parties provided such choice of law coincides with the intention of the parties. It should be noted that, to the extent a law other than Scots law is expressly applied to the contract, such choice of law would need to be pled in order for it to be recognised by the Scottish courts.


The Convention is not in effect in Scotland.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Scotland’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Scotland’s laws or foreign laws)?

The parties are generally permitted to choose the law to govern contractual obligations between them including those arising under a receivables purchase agreement. It is common for portfolios of Scottish receivables to be sold under a contract governed by a law other than Scots law. It is not necessary for the contract of sale to be governed by the same law as the underlying receivables. To the extent that the sale contract creates rights to the underlying receivables beyond mere contractual rights (for example, the purchaser acquiring an equitable proprietary interest in the underlying receivables by execution of the sale contract only), it is unlikely that such additional rights would be effective in respect of Scottish receivables without further action being required.

3.2 Example 1: If (a) the seller and the obligor are located in Scotland, (b) the receivable is governed by the law of Scotland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Scotland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Scotland, will a court in Scotland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes, the Scottish courts will recognise the express choice of Scots law.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Scotland, will a court in Scotland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

It is likely that the Scottish courts will recognise the sale contract and in particular give effect to the sale to the purchaser in questions against the seller and any creditor of, or insolvency practitioner appointed to, the seller. The effect of the sale contract in questions against the relevant obligor and the purchaser may require local country law to be considered.

3.4 Example 3: If (a) the seller is located in Scotland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Scotland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Scotland’s own sale requirements?

It is likely that the Scottish courts will recognise the choice of law in respect of the sale contract and will not require any additional Scots law formalities to be complied with in order to give effect to the transfer of the receivables pursuant to the sale in questions against the seller, the creditors of, or insolvency administrator appointed to the seller.

3.5 Example 4: If (a) the obligor is located in Scotland but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Scotland recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Scotland’s own sale requirements?

See the answer to question 3.4 above.
3.6 Example 5: If (a) the seller is located in Scotland (irrespective of the obligor’s location), (b) the receivable is governed by the law of Scotland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Scotland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Scotland and any third party creditor or insolvency administrator of any such obligor)?

It is likely that the Scottish courts will recognise the choice of law in respect of the sale contract. On the basis that the receivables are governed by Scots law, the transfer of the receivables pursuant to the sale in compliance with the requirements of the purchaser’s country will be recognised by the Scottish courts provided they also comply with the Scots law requirements in respect of the transfer of such receivables.

4 Asset Sales

4.1 Sale Methods Generally. In Scotland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The most common way of a seller to sell receivables to a purchaser is by means of a sale contract supported by an assignment or assignment of the receivables with notice to the relevant obligors or where notice is unattractive (or inconsistent with arrangements to be put in place in other jurisdictions for that particular portfolio) then a trust is declared over the relevant interests under the receivables contracts and related receivables and cash receipts. Scots law does not recognise equitable transfers in respect of Scottish assets and, accordingly, an equitable assignment of the receivable would not, as a matter of Scots law, pass a proprietary interest in the receivables to the purchaser. The trust would, however, create a protected interest in the Scottish receivables which would be good against the seller or any insolvency administrator appointed to the seller.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The sale of Scottish receivables is perfected by the relevant obligors receiving notice of the assignation. Scots law recognises various forms of notice. While the assignation is effective from the date of receipt of notice by the obligor, an acknowledgment of such notice provides evidence of both receipt and understanding of the new arrangements by the relevant obligor.

If the same receivables are assigned by the seller to several third party purchasers all acting in good faith, the order of priority between such purchasers is determined by the date of receipt of notice by the obligor of the assignations. Accordingly, a subsequent third party purchaser who acquires in good faith and notifies the obligor first will take a better title to the receivables than the first purchaser and any intervening purchaser.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Mortgage loans and related security are transferred by formal assignation with notice and, in the case of the transfer of the mortgage security, by registration of such transfer at the Scottish land registers. Many securitisations are structured on the basis of equitable assignments of mortgage loans and related security. Generally, such arrangements are implemented in Scotland by means of an express trust.

Securities which are in bearer form are generally transferable by mere delivery of the relevant security certificate. Instruments which are negotiable in nature may be transferred by a combination of endorsement and delivery with, in certain circumstances, intimation to the relevant obligor under the instrument.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Notice is a requirement of Scots law for the formal transfer of the seller’s interest in the receivable. Prior to notification the obligor can obtain a valid discharge of the debt by paying the seller. The proprietary interest in the receivable remains with the seller until the transfer is intimated to the obligor. Consequently, unless a trust has been declared over the receivables, such interests are available to the creditors of the seller on insolvency.

The consent of the obligor to the sale is not necessary unless expressly required under the contract or unless the principle of delictus personae applies (the contract being of a nature specific to the parties to it). The contract does not need to permit expressly one party to assign or sell its interest to be assignable.

Notice has the effect of limiting rights of set-off affecting the receivables arising from other on-going arrangements between the obligor and the seller. The purchaser acquires the receivable subject to any existing rights of set-off the obligor has against the seller. Notice also prevents the obligor from obtaining a valid discharge of the debt from the seller.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

The form of notice is not prescribed under Scots law. Various forms of notice or intimation are recognised including those permitted by...
the Transmission of Moveable Property (Scotland) Act 1862. The 1862 Act provides for notarial intimation and postal intimation. In the latter case, to obtain the benefit of the terms of the Act, the intimation should contain a certified true copy of the assignation. The notice can be delivered after the sale. The transfer would, however, be subject to the rights of parties who have effected diligence in the meantime, third party purchasers acquiring in good faith, perfected security holders and insolvency administrators appointed to the seller. The intimation can be delivered after the commencement of insolvency proceedings against the obligor. The impact of insolvency of the seller is considered at question 6.1 below.

While an assignation of receivables arising under future contracts is theoretically possible under Scots law, the position is subject to much academic debate and issues arise around the ability to clearly identify the receivable in question. It is a fundamental principle of Scots law for the assignation to be effective that the receivable is either identified or identifiable. Accordingly, assignations of receivables arising under future contracts should be treated with care.

### 4.6 Restrictions on Assignment; Liability to Obligor.

Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Scotland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Scotland recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Such restrictions are generally enforceable in Scotland. There are no particular exceptions to this rule. If a sale is effected in breach of a prohibition, the sale is likely to be ineffective as between the seller and the obligor. A claim for damages for breach of contract may also be available to the obligor.

### 4.7 Identification.

Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The receivables must be identified or identifiable for the purposes of the sale and transfer of the receivables. The receivables must be ascertainable for the purpose of any transfer. Relevant information usually includes the obligor’s name, invoice number, invoice date and amount. The receivables being sold do not need to share objective characteristics. It is possible for the seller to contract to sell all of their receivables to the purchaser or all receivables other than those specifically excluded (and identifiable). It is unlikely that this would be sufficient to identify the receivables for the purpose of an assignation and notice.

### 4.8 Respect for Intent of Parties; Economic Effects on Sale.

If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

A transaction expressed to be a sale may be re-characterised by the courts in Scotland as potentially a secured financing in certain circumstances. True sale analysis of the sale is usually undertaken. In the Scottish context, this involves reviewing the transaction documentation and deal structure and considering the tests applicable in the English case of Re Inglefield and an assessment of the ‘ultimate right’ in the receivables sold. No single factor will result in the transaction being characterised as a sale or a secured financing. Retention of credit risk by the seller may suggest that the purchaser has not truly acquired the receivables and accordingly buy back provisions are required to be formulated with care. Again, interest rate risk may be characterised as either an indication of true ownership being retained by the seller or merely a purchase price adjustment mechanism. Control of collections of receivables when such services are provided for a commensurate fee and where the seller does not retain any economic exposure to the receivables either for failing to collect or entitlement to profit from collection is unlikely in itself to result in the sale being re-characterised.

### 4.9 Continuous Sales of Receivables.

Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

The seller can agree in an enforceable manner to a continuous sale of receivables as and when they arise (at least so far as the purchaser acquiring a contractual right to the receivables) provided such receivables are identifiable. Such contractual arrangements would be effective until insolvency of the seller.

### 4.10 Future Receivables.

Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

See question 4.9 above. The transfer of such receivables to the purchaser would, however, need to be documented separately and an automatic transfer of such receivables (at least in respect of Scottish receivables) is unlikely to be recognised by the Scottish courts without the Scottish formalities being met. To the extent relating to future receivables, we would generally recommend that express supplemental trusts are declared over receivables as and when they are originated (or regularly in batches) pending formal transfer of the receivables to the purchaser.
4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Each relevant interest should be transferred in accordance with the formal transfer requirements under Scots law unless the security is held on a syndicatable security trust basis. Related security is generally assigned to the purchaser under Scots law and notice given to obligors or registrations at the relevant Scottish land register depending upon the security involved. Under Scots law, an assignation has the effect of ‘ruling off’ the liabilities secured by the related security at the time of the transfer. Accordingly, further advances would be unsecured unless the security is amended or new security is granted to support the further advance. Pending formal transfer, a trust is commonly declared in favour of the purchaser over the receivables and related security. This can also cover certain ancillary rights which are difficult to formally transfer to the purchaser.

5 Security Issues

5.1 Back-up Security. Is it customary in Scotland to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary in Scotland to take back up security over the seller’s interest in the receivables in the event that the sale is deemed by the court not to have been perfected or being re-characterised as a secured financing.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Scotland, and for such security interest to be perfected?

The formalities for granting fixed security over receivables are similar to those in respect of the transfer of such an interest. Accordingly, the receivable should be assigned to the purchaser and notice given to the obligor. The form of security required in respect of related security interests will depend upon the security involved. In addition, a corporate seller may grant a floating charge over its assets including the receivables and related security. The security may also need to be registered at Companies House. The Financial Collateral Arrangements No.2 Regulations 2003 also apply in Scotland.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Scotland to grant and perfect a security interest in purchased receivables governed by the laws of Scotland and the related security?

Same as question 5.2 above. The purchaser may also hold an interest as beneficiary under a trust declared by the seller over the relevant receivables. Such an interest is capable of being subject to fixed security by means of an assignation duly intimated to the seller.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Scotland, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Scotland or must additional steps be taken in Scotland?

To the extent that the receivables are governed by Scots law, the Scottish courts may not recognise any security granted over such receivables which falls short of the Scots law formalities in respect of such security. The appropriate form of security is set out under question 5.2 above.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

See questions 4.3 and 4.11 above.

5.6 Trusts. Does Scotland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Trusts are recognised as a matter of Scots law under the Recognition of Trusts Act 1987.

5.7 Bank Accounts. Does Scotland recognise escrow accounts? Can security be taken over a bank account located in Scotland? If so, what is the typical method? Would courts in Scotland recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Scotland?

Scotland recognises arrangements whereby parties hold funds in a designated account and agree to the release of such amounts following satisfaction of certain conditions or on the consent of all relevant parties. Security can be created over bank accounts in Scotland. Certain issues arise in respect of security granted over accounts in favour of the account bank. In such circumstances the security relies upon the operation of set-off. The typical method of taking security is by means of a bank account pledge and assignment duly intimated to the account bank. The Scottish courts would recognise a foreign law grant of security taken over a bank account to the extent that the form of security complies with the Scots law formalities for such a charge.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

The rights of the account bank (such as rights of set off) will usually be waived under the security and the terms of any acknowledgement to be signed by them. All amounts received into the account are secured. An arrestor of the bank account should rank behind the holder of an existing duly perfected account charge. Insolvency should not affect the validity of any fixed security over sums subsequently received into the bank account although in practice an insolvency official may seek to divert payments which the purchaser is only contractually obliged to procure are made to...
such an account. The terms of the bank account security itself can affect the position.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Control by the account holder over the funds in the account is inconsistent with a duly perfected charge under Scots law. Accordingly any such arrangements, which occur frequently in practice, would affect the security. The relevant account should be blocked in order for effective security to be created in Scotland.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Scotland's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Most insolvency proceedings for corporate entities provide for some form of automatic stay of action or moratorium preventing court proceedings from being raised or enforcement action being taken against the insolvent entity or its assets for a period of time without either the insolvency practitioner’s consent or consent of the court. This would prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables to the extent they continued to be assets of the seller at the time of commencement of insolvency proceedings. If, however, ownership of the receivables have been transferred to the purchaser and that transfer has been perfected, the purchaser could sue the obligor in its own name without reference to the insolvent entity.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

On the basis that the receivables have been transferred to the purchaser and that transfer has been perfected, the Insolvency Official should have no power to interfere with the purchaser’s exercise of rights in respect of the receivables unless the transfer is capable of challenge under the various creditor protection provisions outlined under question 6.3 below.

6.3 Suspect Period (Clawback). Under what facts or circumstances could theLe Insolvency official resind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Scotland for (a) transactions between unrelated parties and (b) transactions between related parties?

UK Insolvency legislation contains creditor protections which give rise to suspect periods during which transactions may be rescinded or reversed. Certain protections have UK-wide application and, as such, also apply in Scotland (for example, s. 245 (Avoidance of certain floating charges) of the Insolvency Act 1986). Transactions entered into by Scottish companies and certain overseas companies may be subject to the provisions of ss. 242 and 243 of the 1986 Act (Gratuitous alienations and Unfair preferences) and to Scots common law equivalents.

The relevant period to challenge a gratuitous alienation is five years for a transaction with a connected party and two years for any other person and the period for challenge of an unfair preference is six months. An alienation cannot be challenged as gratuitous if: (i) immediately or at any other time after the alienation the company’s assets were greater than its liabilities; or (ii) the alienation was made for adequate consideration. An unfair preference is a transaction which has the effect of creating a preference in favour of a creditor to the prejudice of the general body of creditors. A transaction is not a preference if (i) it is in the ordinary course of trade or business, or (ii) it involves the parties undertaking reciprocal obligations unless the transaction was collusive with the purpose of prejudicing the general body of creditors.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

This doctrine is not recognised under Scots law. In addition, the courts will only pierce the corporate veil in very limited circumstances.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Scotland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

The contractual obligations continue albeit the purchaser is likely to have only a claim against the seller’s estate which will rank with other unsecured creditors. As the future Scottish receivables are not transferred to the purchaser without further action of the seller (i.e., the grant of an assignation duly notified to the relevant obligors), the Scottish receivables will remain the property of the seller unless the Insolvency Official transfers the receivables to the purchaser pursuant to the sale contract.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Scotland establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no special securitisation law or special provisions in other law in Scotland establishing a legal framework for securitisation transactions, although particular tax laws may apply.
7.2 Securitisation Entities. Does Scotland have laws specifically providing for establishment of special purpose entities for securitisations? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

There are no mandatory or special requirements in respect of the establishment of special purpose entities for securitisations in Scotland.

7.3 Non-Recourse Clause. Will a court in Scotland give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Generally the courts in Scotland would recognise a non-recourse clause.

7.4 Non-Petition Clause. Will a court in Scotland give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Although there is no direct Scottish authority in this regard, non-petition clauses are likely to be valid in Scotland provided such provisions are not contrary to public policy. A Scottish court might still accept a winding up petition contrary to the terms of a non-petition clause resulting instead in only a damages claim for breach.

7.5 Priority of Payments “Waterfall”. Will a court in Scotland give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes. Pre-insolvency of the purchaser, contractual arrangements fixing the priority of distributions are of a type which would be recognised by the Scottish courts. Priority of payments of unsecured amounts post insolvency may still be recognised, however, as a general rule an insolvency official would not be bound by the terms of such provisions and is required to pay creditors in accordance with statutory rules.

Payments in breach of such arrangements will create only contractual rights. If such provisions are not contrary to public policy, the Scottish courts will still accept a winding up petition contrary to the terms of a non-petition clause. However, to the extent such provisions are contrary to public policy, they would be unenforceable. The directors have overriding duties to creditors including where appropriate to call for winding up or administration of a corporate entity in certain circumstances. It is unlikely that such provisions would be overridden by contractual or constitutional document provisions.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Scotland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Scotland? Does the answer to the preceding question change if the purchaser does business with other sellers in Scotland?

The acquisition, collection or ownership of receivables will not in itself result in the purchaser being required to do business or to obtain a licence or its being subject to regulation as a financial institution in Scotland unless such activities are regulated (for example origination or administration of regulated mortgage contracts for which FSA authorisation would be required) or constitute consumer credit activities (for which a consumer credit licence would be required). In either case, Data Protection Act registration should also be obtained.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Servicing activities are likely to require a CCA licence or require FSA authorisation if they relate to consumer credit activities or regulated activities. Any third party replacement servicer will require the same licences and authorisations.

8.3 Data Protection. Does Scotland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The provisions of the Data Protection Act 1998 apply in Scotland. The laws apply only to individuals and not to enterprises.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Scotland? Briefly, what is required?

If the obligors are consumers, the purchaser will probably be required to comply with the UK consumer credit protection laws and to be licensed under the CCA.

If the contract constitutes a regulated mortgage contract (or equivalent regulated contract) for the purposes of the Financial Services and Markets Act 2000, the purchaser would need to be authorised by the FSA and comply with the detailed requirements of the FSA Handbook relating to such contracts.

Certain unfair terms in consumer contracts may not be enforceable against the consumer. Similarly, provisions in a contract, which purport to restrict liability of a party for damage caused, may be restricted or struck at by the Unfair Contract Terms Act 1977.
8.5 Currency Restrictions. Does Scotland have laws restricting the exchange of Scotland’s currency for other currencies or the making of payments in Scotland’s currency to persons outside the country?

Subject to currency transfer and dealing restrictions applicable under current United Nations Sanctions and to compliance with anti-money laundering/anti-terrorism legislation, there are no restrictions on currency exchange or the making of payments to persons outside Scotland.

9.4 Value Added Taxes. Does Scotland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

VAT is generally payable in Scotland in respect of the supply of goods and services within the UK by taxable persons in the course or furtherance of a business. The current standard rate of VAT is 20 per cent, although different rates apply depending upon the goods or services supplied. Certain supplies are exempt and some transfers are outside the scope of VAT.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

To the extent payable, VAT has to be accounted for by the provider of services only (i.e., the seller). Stamp duty liability falls to the party seeking to enforce the transfer (i.e., the purchaser). Generally, HM Revenue & Customs would not have a claim against the purchaser for VAT for which the seller had to account.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Scotland, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Scotland?

The purchase of receivables by the purchaser or its appointment of the seller as its servicer and collection agent should not in itself result in the purchaser being liable to pay tax in Scotland; however, as with the rest of the UK, enforcement of receivables may require more detailed consideration. In each case, however, all circumstances need to be considered and advice obtained.
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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Under Slovak law an enforceable debt obligation may be created as expressed or implied. In case of an expressed debt obligation, the parties enter into a formal written receivables contract where all the essential terms are expressly stipulated. However when creating an implied debt obligation the parties rely solely on each other’s behaviour without any real guarantees. An invoice is insufficient in itself to create an enforceable debt obligation and it ranks amongst expressed debt obligations.

1.2 Consumer Protections. Do the Slovak Republic’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

The Slovak Republic has adopted various legal rules aimed to protect the consumer as the one seeking special protection in legal relationships. First of all, Act No. 40/1964 Coll. of the Civil Code as amended (“Civil Code”) involves a number of provisions governing general principles of the relationships with consumers and the detailed regulation of consumer agreements. In particular, consumer agreements are very strictly considered and might be deemed void unless meeting stringent legal conditions. Secondly, special Act No. 250/2007 Coll. on Consumer Protection as amended regulates specific issues of consumer relations. Based on the adoption of this Act, implementation of numerous European regulations focused on consumer protection was achieved. When it comes to the statutory right to interest on late payments, the Slovak Republic’s law provides for such a right even if not agreed in an agreement. Under the provisions of the Civil Code, where a default in the performance of a monetary debt is concerned, the creditor shall have the right to require the debtor to pay late payment interest in addition to the performance. The amount of the late payment interest and charge is set out in implementing Regulation No. 87/1995 Coll. by the Government regulating enforcement of the Civil Code as amended and supplemented and it is increased by five percentage points above the European Central Bank’s interest rate valid on the first day of the delay with the payment. Despite many protecting tools, there are no limitations related to rates of interest on consumer credit, loans or other kinds of receivables.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

When the government or a government agency enter into contract, including a receivables contract, it shall be considered a legal entity and therefore shall be treated as any other legal entity in similar legal relationships. However, following the latest amendment to Act No. 513/1991 Coll. on the Commercial Code (“Commercial Code”) special rules regulating timely monetary performance apply since 1 February 2013. In case a government or government agency is the debtor, the statutory time frame for monetary performance is 30 days unless otherwise agreed. However, agreement on longer periods cannot be grossly disproportionate to the rights and obligations arising from the contractual relation for the creditor and cannot exceed 60 days.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the Slovak Republic that will determine the governing law of the contract?

The seller and obligor are obliged to choose the applicable law only under condition there is any international dimension to their relationship. Provided there is such an international dimension and lack of chosen applicable law, the time of executing the contract and the origin of parties are crucial. Contracts concluded before 31 July 2006 shall be governed by the Act No. 97/1963 Coll. on Private International Law and Procedure as amended (“Act on International Law”). Contracts executed after 1 August 2006 are subject to the Convention on the Law Applicable to Contractual Obligations No. 80/934/EEC (“Rome Convention”) and the Act on International Law with regard to the issues that are not governed by the Rome Convention; and since 17 December 2009 Regulation (EC) No. 593/2008 of the European Parliament and of the Council on the Law Applicable to Contractual Obligations (“Rome I”) applies together with the Act on International Law on issues not governed by Rome I. After identification of time of execution of the contract and the parties, the applicable law would be determined...
3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does the Slovak Republic’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Slovak Republic’s laws or foreign laws)?

Slovak law does not generally require the sale of receivables to be governed by the same law as the law governing receivables themselves. The chosen applicable law would be followed provided there is an international dimension in the relationship.

3.2 Example 1: If (a) the seller and the obligor are located in the Slovak Republic, (b) the receivable is governed by the law of the Slovak Republic, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the Slovak Republic to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the Slovak Republic, will a court in the Slovak Republic recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

In Slovak law, such a transfer of the receivable shall be effective against the obligor provided that the seller duly notified the obligor of such transfer. Otherwise, the obligor is entitled to fulfil the performance in favour of the seller. Effectiveness against other persons shall be undoubted.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside the Slovak Republic, will a court in the Slovak Republic recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

A Slovak court would inspect that the requirements laid down by the law that was agreed as the applicable law for the transfer of the receivable, are met.

3.4 Example 3: If (a) the seller is located in the Slovak Republic but the obligor is not, or if the obligor is resident in the Slovak Republic but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the Slovak Republic give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

A Slovak court would be bound by such choice of law and apply this law on the transfer of receivables provided that choice of law is valid.

3.5 Example 4: If (a) the obligor is located in the Slovak Republic but the seller is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in the Slovak Republic recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Slovak Republic’s own sale requirements?

The choice of governing law is crucial and a Slovak court shall apply its rules provided that choice of law is valid.
3.6 Example 5: If (a) the seller is located in the Slovak Republic (irrespective of the obligor’s location), (b) the receivable is governed by the law of the Slovak Republic, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in the Slovak Republic recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the Slovak Republic and any third party creditor or insolvency administrator of any such obligor)?

Slovak courts would apply the provisions of the chosen applicable law, provided that such choice is valid. However, as the receivable is governed by Slovak law, the obligor shall be notified of the receivable transfer.

4 Asset Sales

4.1 Sale Methods Generally. In the Slovak Republic what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

Under Slovak law the term “assignment” is preferably used when selling the receivable. Therefore the seller is designated as the assignor and the purchaser as the assignee. The transfer of the receivable means the change of the creditor.

The receivable transfer (i.e. sale of receivable) is conducted upon the creation of a written contract between the seller and the purchaser and although the consent of the obligor is not required, he must be notified of such transfer. A transfer is permitted only under the condition that it is not in contrary with the agreement between the seller and the obligor.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

No additional formalities are required for perfecting a sale of receivables.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The assignment of promissory notes is subject to a special law and in order to be assigned the endorsement shall be executed. Marketable debt securities shall be assigned by endorsement as well; however the registration of the change shall be done within the Central Depository of Securities. Mortgage loans and consumer loans are accessory rights and therefore follow the destiny of the receivable which is secured.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Under Slovak law the obligor must be notified of the sale of receivables in order for the sale to be effective against the obligor, i.e. the obligor must be notified on the change of his creditor (seller). Otherwise, the obligor is entitled to fulfil its obligation in favour of the seller (i.e. the original creditor) and the seller is obliged to accept such fulfilment. Notification of the sale might be performed by either the seller or the purchaser. In case of notification by the seller, mere notification of the sale is sufficient. However, when the purchaser notifies the sale, he has to also prove the assignment by showing the assignment agreement.

A receivables assignment is not allowed if the receivables contract expressly prohibits such assignment. However if the receivables contract neither expressly prohibits assignment nor expressly permits assignment, there is a possibility to conduct an assignment in accordance with the Civil Code. The obligor’s consent for the sale is not required unless otherwise agreed in the receivables agreement.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

The Civil Code does not stipulate any closer terms of the form of notice. With reference to the time limit, the Civil Code lays down that the notice shall be delivered without undue delay after the sale. Notice as described applies only to specific receivables already assigned. When it comes to insolvency proceedings against the obligor, the notice shall have no effect. However when the insolvency proceedings against seller have been commenced, the receivables assignment itself is not allowed. Delivery of the notice is not crucial from this point of view as it is only the consequence related to assignment.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in the Slovak Republic? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the Slovak Republic recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions on a receivables assignment are either statutory or contractual:
4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

When assigning the receivables, each of them must be specifically identified. Although Slovak law does not enumerate exact characteristics for sufficient determination of receivables, the receivable must be identifiable in any case. Specification of the receivables on the basis of relation with some obligor would not be sufficient enough and may be considered by a court as unenforceable.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

If the parties denominate their transaction as a sale and the related security is to be perfected as a result of such declaration, is the sale to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the sale's perfection? Sales of future receivables are not prohibited under Slovak law; however the future receivables must also be identifiable as already mentioned to be effectively assigned.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Continuous sale of receivables is allowed. Receivables must be identifiable as previously mentioned to be effectively assigned.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller's insolvency?

Generally under Slovak law, when the transferred receivable is secured, related security follows destiny of such receivable. As a consequence, upon transfer of the receivables, the purchaser becomes the owner of both the receivable and security. It is suitable to inform the security provider on such transfer.

5 Security Issues

5.1 Back-up Security. Is it customary in the Slovak Republic to grant and perfect a security interest in purchased receivables governed by the laws of the Slovak Republic? If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the Slovak Republic, and for such security interest to be perfected?

In the Slovak Republic it is not usual to take back-up security over the seller’s ownership interest.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the Slovak Republic, and for such security interest to be perfected?

As already mentioned above, the seller security is not usual. However, generally speaking, the most essential formalities for the establishment of security is a written contract expressly clarifying the secured claim as well as security.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the Slovak Republic to grant and perfect a security interest in purchased receivables governed by the laws of the Slovak Republic and the related security?

First of all, the written contract shall be concluded between the purchaser and the funding provider. According to the nature of the security, different requirements must be fulfilled in order to establish perfect security. Generally, the registration of the security interest with the Notary Register of Securities is required (unless any other registration is laid down by law).
5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the Slovak Republic, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in the Slovak Republic or must additional steps be taken in the Slovak Republic?

Unless such security interest is contrary to Slovak policy and mandatory provisions, it shall be deemed as valid and perfected.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

The following additional formalities apply:
- in case of marketable debt securities, the registration with Central Depository is required;
- in case of promissory notes, the security endorsement is required;
- in case of mortgage loans, usually the registration with cadastral office is required; and
- in case of consumer loans, there are no special requirements.

5.6 Trusts. Does the Slovak Republic recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

Slovak law does not recognise the trusts as described above.

5.7 Bank Accounts. Does the Slovak Republic recognise escrow accounts? Can security be taken over a bank account located in the Slovak Republic? If so, what is the typical method? Would courts in the Slovak Republic recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the Slovak Republic?

Escrow accounts are recognised in the Slovak Republic and very often apply in practice. Mostly, the escrow accounts are used when granting the security for payment of the purchasing price of real estate.

Further, Slovak law allows taking security over a bank account located in the Slovak Republic. Such security is established upon the written contract between the creditor and the obligor. Finally, the registration of the security with the Notary Register of Securities is required.

A foreign-law grant of security would be recognised provided that all the mandatory provisions including public policy are met.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

When establishing the security over a bank account, the bank must be notified of such establishment. Consequently, the bank, as the sub-debtor, has control over the funds in the account, not the secured party.

After the enforcement procedure is commenced, debtor is prohibited to dispose the funds in the account up to the amount of a secured receivable and its accessories. Limits for this prohibition are in the amount of EUR 194.58 which represents the minimum cost of living for 2013 and must be provided to debtor. Moreover, the prohibition does not take place in case the funds in the bank account are aimed to be paid up as salaries for the debtor employees.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Prior to enforcement, the bank account owner has access to the funds without limitations.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the Slovak Republic's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")?

Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Upon obtaining the ownership over the receivable, there is no "stay of action" possible and the purchaser is entitled to perform all his rights related to the purchased receivable.

If the purchaser is a secured party, his position in the insolvency proceedings shall be as the secured creditor. The secured creditor shall be satisfied on the basis of liquidation of debtor assets against which the receivable has been secured. As opposed to unsecured creditors, the secured creditors shall be preferably satisfied.

6.2 Insolvency Official's Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of rights (by means of injunction, stay order or other action)?

The bankruptcy trustee as the insolvency official has the power to object the legal actions of the obligor related to his assets in bankruptcy. Such objection is ruled by the court. Moreover the bankruptcy trustee is liable during the bankruptcy proceedings for listing the assets which are subject to bankruptcy. Slovak law enables to exclude an asset from such list upon taking legal action.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in the Slovak Republic for (a) transactions between unrelated parties and (b) transactions between related parties?

As described in question 6.2 above, the insolvency official may rescind or reverse suspicious transactions under the Slovak insolvency law. Suspicious transactions are transactions of the obligor which aim to reduce the potential for satisfaction of
The Slovak Republic does not have laws specifically providing for establishement of securitisation entities. The establishment of securitisation entities is conducted by the insolvency official. Keeping the business in normal course but these operations shall be conducted by the insolvency official. If insolvency proceedings are commenced against the seller in the Slovak Republic, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

With reference to the receivables against the seller, such receivables shall be listed by insolvency officials in the list of assets that is subject to insolvency proceedings. However, the creditor (owner of the future receivable) is entitled to execute its rights in insolvency proceedings only upon proving the existence/occurrence of the receivable to the insolvency official.

With reference to the receivables of the seller, the seller as an insolvent person in insolvency proceedings is strictly prohibited from dealing with his asset that is subject to insolvency proceedings. The only exemptions are operations required for keeping the business in normal course but these operations shall be conducted by the insolvency official.

**7 Special Rules**

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Slovak Republic establishing a legal framework for securitisation transactions? If so, what are the basics?

Under Slovak law there is not special securitisation law. The Civil Code provides for the basic securitisation institutes (e.g. pledge agreement, retention, contractual penalty, surety, etc.) which are applicable in any branches of the law.

7.2 Securitisation Entities. Does the Slovak Republic have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

The Slovak Republic does not have laws specifically providing for the establishment of securitisation entities.

7.3 Non-Recourse Clause. Will a court in the Slovak Republic give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

With reference to a receivable assignment, the seller is liable to the purchaser for the enforcement of the assigned (sold) receivable only under the conditions that: (i) the assignment was conducted for the consideration; and (ii) the seller agreed with such liability to the purchaser. The liability of the seller shall be up to the amount of accepted consideration and interests.

7.4 Non-Petition Clause. Will a court in the Slovak Republic give effect to a contractual provision (even if the contract's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Slovak law does not accept non-petition clauses as in accordance with Slovak law “non-petition clause” means the waiver of the future rights and that is strictly considered as invalid. This shall apply not only in consumer relations but also in commercial relations. Despite this, when the relation is governed by foreign law, Slovak courts may follow such a provision and avoid applying Slovak public policy.

7.5 Priority of Payments “Waterfall”. Will a court in the Slovak Republic give effect to a contractual provision (even if the contract's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

As stated in question 7.4 above, when the relation is governed by a foreign law, it might be accepted by Slovak courts as an effective provision.

7.6 Independent Director. Will a court in the Slovak Republic give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

As already mentioned in questions 7.4 and 7.5, such a provision might be deemed as effective only when subject to foreign law. Upon Slovak law such provision would be considered as unenforceable as the directors are obligated by law to take special care of the company and -e.g.- not commence insolvency proceedings when all the conditions are met that might have penal consequences for the directors.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the Slovak Republic, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the Slovak Republic? Does the answer to the preceding question change if the purchaser does business with other sellers in the Slovak Republic?

Purchase and ownership of receivables does not require any licence in the Slovak Republic. Whereas collection and enforcement may be deemed a business activity, when conducted independently, continuously, in the company’s own name, under its own responsibility and in order to gain profit it shall consequently be performed solely on the basis of a business trading licence. Financial institution regulation does not apply in case of any of the activities aforementioned.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to collect and enforce receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Upon request of the purchaser, Slovak law enables the seller to enforce an assigned (sold) receivable in the seller’s own name and on the purchaser’s account. In such a case no licences are required. However when the assignment (sale) was already noticed to the obligor, the seller may enforce the receivable only under the conditions that the purchaser does not enforce the receivable and that the seller proves to the obligor the purchaser’s consent with enforcement. With reference to court appearance, the seller shall prove his entitlement to act as he is no longer the owner of the receivable.

The collection and enforcement of purchased receivables by a third party replacement servicer is likely to require the business trading licence especially when performed by the servicer independently, continuously in the name of servicer, in his own responsibility and in order to gain profit.

8.3 Data Protection. Does the Slovak Republic have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

The Slovak Act on Data Protection is focused solely on the protection of personal data; therefore when the obligor is a legal entity (enterprise) data protection according to the Slovak Act on Data Protection does not apply. Data protection includes various duties to be fulfilled with the Personal Data Protection Office, particularly a special notification of personal data processing.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the Slovak Republic? Briefly, what is required?

Slovak protection of consumers is notable especially in the field of granting credit loans to consumers. Slovak Act No. 129/2010 Coll. on Consumer’s Credit Loans stipulates a number of special entitlements only for consumers as the one required to be protected in credit relations, e.g.:

- the consumer is entitled to withdraw from the agreement on consumer credit loan without any reason within 14 days since the execution of such an agreement or since delivery of the standard business terms;
- the consumer is entitled to terminate the agreement on consumer credit loan concluded for an indefinite time period in any time for free with immediate effect unless agreed on termination period; and
- the consumer has the right to pay up the loan credit fully or partially before its maturity at any time during the period of the agreement on the consumer credit loan.

8.5 Currency Restrictions. Does the Slovak Republic have laws restricting the exchange of the Slovak Republic’s currency for other currencies or the making of payments in the Slovak Republic’s currency to persons outside the country?

In accordance with the Plan of the Fight against Tax Frauds as of 1 January 2013 the Slovak Republic has adopted the new law restricting cash payments. On the basis of the new law there are restrictions in cash payments performed in any of the currency by an entity related to the Slovak Republic (by seat, residence, branch office, etc.). Payment limits are EUR 5,000 in the case of transactions between legal entities and entrepreneurs and EUR 15,000 in the case of transactions between individuals.

Exchange of Slovak Republic currency (i.e. Euro) for any other currency is not restricted. Moreover exchange services are exempted from the new act.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the Slovak Republic? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Depending on the nature of the receivable, payment on receivables by the obligor to the seller or to the purchaser shall be subject to withholding taxes in the Slovak Republic.

9.2 Seller Tax Accounting. Does the Slovak Republic require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The Slovak Republic does not require any special accounting rules in the context of a securitisation.

9.3 Stamp Duty, etc. Does the Slovak Republic impose stamp duty or other documentary taxes on sales of receivables?

There is no stamp duty or other documentary taxes on sale of receivables imposed in the Slovak Republic.
9.4 Value Added Taxes. Does the Slovak Republic impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The sale of services in the Slovak Republic, sale of goods in the Slovak Republic and acquiring goods in the Slovak Republic from other EU Member States are subject to value added tax (VAT). However, there are numerous exemptions when VAT is not payable e.g. postal services, insurance services, financial services, rental services, etc.

Receivable assignment (sale) is not considered a sale of services according to Slovak law regulating VAT therefore receivable assignment is not subject to VAT.

When it comes to collection agents, their activity is not included within VAT exemptions and consequently the fees for their activity shall be subject to VAT in the Slovak Republic provided that the origin of the taxable supply is located in the Slovak Republic.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Taxing authority would be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections only under certain conditions:
(i) if the purchaser is a Slovak taxable resident; and
(ii) if the purchaser had, should have, or could have known that taxes were not going to be paid at the moment of realisation of the sale.

9.6 Doing Business. Assuming that the purchaser conducts no other business in the Slovak Republic, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the Slovak Republic?

If purchaser is not a Slovak resident but he acquires an income originating in the Slovak Republic, he shall be obliged to make a tax return according to Slovak law and submit it to the Slovak tax authorities.
Chapter 36

Spain

Uría Menéndez Abogados, S.L.P.

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

As a general rule, under Spanish law, agreements do not need to be formalised in writing. Verbal agreements and tacit agreements (those which are construed as a result of the behaviour of the parties) are, as a matter of principle and except for certain types of contracts, fully enforceable between the contracting parties. However, the difficulties to evidence the contracting terms and conditions for verbal and tacit agreements have resulted in a generalised use of written agreements for the sale of goods and services. As a result, the Spanish Civil Code favours the written form for contracts and, though not refusing to render valid verbal agreements, does vest the parties with the right to request written form from their counterparties. Moreover, specific Spanish regulations (such as some of those protecting consumers, banking, etc.) do impose mandatory written form.

As they are not usually signed by the recipient, invoices do not per se create an enforceable debt obligation of the obligor to the seller. However, together with other means of evidence, they can help to prove the existence of a contract between the obligor and the seller.

1.2 Consumer Protections. Do Spanish laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Limits on rates of interest: Spanish law does not provide for a specific threshold rate beyond which interest should be generally treated as usurious (which would render the relevant loan or credit provision null and void). The only parameter is set out in the law on Usury Repression, of 23 July 1908, which establishes that loan agreements providing for rates of interest which exceed by far the “normal” interest and are manifestly excessive taking into account the circumstances of the case, shall be null and void. Over the years, this law has been applied in a large number of judicial precedents, which examine the specific circumstances surrounding each case, thus making it difficult to draw general conclusions.

Interest rate restrictions apply as well in the context of certain consumer-related transactions. Credit facilities granted by credit institutions to consumers and associated to a bank account may be drawn upon in excess of the available funds. Any such overdraft shall bear interest at an effective rate which cannot exceed the legal limit of 2.5 times the legal interest rate in force from time to time (the legal interest rate is regularly fixed by the government on a yearly basis). Similarly, certain public housing-related mortgages are subject to interest rate limitations or, otherwise, require the use of regulated criteria and formulae which result in rate restrictions.

Additionally, Royal Decree-Law 6/2012, of 9 March, on urgent measures to protect low income mortgage debtors (“RDL 6/2012”) establishes a voluntary adherence good practices code for credit entities and professional lenders. Once the relevant credit entity voluntarily adheres to the code (which up to this date, almost all Spanish credit entities have done), the code becomes mandatory for such credit entity.

Furthermore, RDL 6/2012 provides for a mandatory and temporary cap to the ordinary interest rate applicable to already existing residential mortgage loans granted for the acquisition of properties for a price below certain levels to individuals who evidence to fall below the exclusion threshold (as it is legally defined in Article 3 of RDL 6/2012).

Interest on late payments: Unless the contract between the seller and the obligor provides otherwise, the Spanish Civil Code provides that late payments trigger the obligation on the obligor to pay default interest to the seller, at the legal interest rate and calculated as from the date the seller demands payment of the relevant amount.

RDL 6/2012 also provides for a compulsory (i.e., not subject to adherence to the good practices code by the creditors) cap for default interest (ordinary interest plus 2.5 per cent) applicable to already existing residential mortgage loans granted to individuals who evidence to fall below the exclusion threshold (as it is legally defined in Article 3 of RDL 6/2012).

Consumers’ withdrawal rights: Consumers are entitled to cancel an agreement (and therefore the receivables arising thereunder) if provided under the applicable sector legislation (for instance, financial and telecommunications sectors include withdrawal rights in favour of the consumers) or as agreed between the seller and the obligor-consumer. Unless a different term is provided under the applicable sector legislation, consumers are entitled to cancel the consumer agreement during a period of seven working days since the delivery of the goods or the execution of the service agreement (as the case may be), provided that the seller duly informed the obligor-consumer of the existence and characteristics of the withdrawal right (otherwise, the term would be seven working days
since the information obligations have been duly fulfilled, up to a maximum of three months since the delivery of the goods or the execution of the service agreement).

When it comes specifically to consumer financing, Spanish Act 16/2011, of 25 June, on consumer finance (“Act 16/2011”), which implements Directive 2008/48/EC, of 23 April, provides for a withdrawal right in favour of the obligor-consumer (that can trigger it without giving any reason) for a period of 14 calendar days as from the later date between (i) the date of execution of the credit agreement, and (ii) the date of delivery of certain financial information and terms by the credit institution to the consumer. Where the consumer elects to exercise its withdrawal right, the creditor shall not be entitled to any compensation other than payment of the capital and interest accrued from drawdown of the credit until full repayment.

On a similar note, Spanish Act 22/2007, of 11 July, on distance marketing of financial services to consumers establishes a similar 14 calendar-days’ withdrawal right.

Lastly, the Spanish government is now considering several measures intended to introduce certain restrictions on the ability to impose excessive default rates on mortgage consumers. If finally approved, these rules would most likely provide for a cap on default interest.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Royal Legislative-Decree 3/2011, of 14 November (“Act 3/2011”), regarding public sector contracts, provides for the legal regime applicable to agreements entered into by the majority of public entities (which would include the general, regional or local administrations, but also public-owned or public-controlled entities, such as organismos autónomos, entidades públicas empresariales y empresas públicas) and third parties. Specific provisions are provided therein for the sale and collection of receivables.

That said, the legal regime applicable to the sale of receivables arising out of agreements subject to Act 3/2011 is, in substance, equivalent to the general regime provided under the Spanish Civil Code (and which shall be described below), including, in particular, the need to notify the obligor in order for the assignment to be fully effective against the obligor. The collection of receivables against public entities is subject to customary procedures followed by public entities (e.g. the need to have budgetary support for any agreed payment, applicable sovereignty principles, etc.), and is usually based in the issuance of payment mandates by the relevant entity. Act 3/2011 and other regulations on the payment of business receivables impose strict payment terms of the Spanish public administrations and entities, including very onerous late payment interest duties.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Spain that will determine the governing law of the contract?

Under Regulation (EC) No 593/2008 of the European Parliament and of the Council, of 17 June 2008, on the law applicable to contractual obligations (Rome I) (“Regulation 593/2008”), which is directly applicable in Spain, to the extent that the law applicable to the contract has not been chosen by the parties, the law governing the contract shall be, in principle, determined in light of the nature of the agreement. Pursuant to paragraphs (a) and (b) of Article 4.1 of Regulation 593/2008, the law governing the contracts for the sale of goods or the provision of services would be, in principle, the law of the country where the seller or provider of services has his habitual residence. Having said that, if it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that resulting from the application of Article 4.1 of Regulation 593/2008, the law of that other country shall apply.

However, where the contract for the sale of goods or the provision of services is entered into with obligors qualifying as consumers, it shall be governed by the law of the country where the consumer has his habitual residence, provided that the professional (a) pursues his commercial or professional activities in the country where the consumer has his habitual residence, or (b) by any means, directs such activities to that country or to several countries including that country, and the contract falls within the scope of such activities.

2.2 Base Case. If the seller and the obligor are both resident in Spain, and the transactions giving rise to the receivables and the payment of the receivables take place in Spain, and the seller and the obligor choose the law of Spain to govern the receivables contract, is there any reason why a court in Spain would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Spain but the obligor is not, or if the obligor is resident in Spain but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Spain give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Yes, pursuant to the freedom of choice principle established by Article 3 of Regulation 593/2008.

However, application of the Spanish overriding mandatory provisions (i.e., those provisions the respect for which is regarded as crucial by Spain to safeguard its public interests, such as its political, social or economic organisation) shall not be limited. Furthermore, Spanish courts may refuse the application of a provision of the chosen law if such application is manifestly incompatible with Spanish public policy. Finally, if the chosen law is not from a Member State of the EU and all elements relevant to the situation at the time of the choice of law are located in one or more Member States, the parties’ choice of law shall not prejudice the application of provisions of European Union law which cannot be derogated by agreement.

Typically, none of these limitations would apply in commercial relationships such that between the seller and the obligor under a receivables contract.


Yes, and it is in force in Spain since 1 August 1991.
3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Spanish law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Spanish laws or foreign laws)?

Pursuant to the freedom of choice principle established by Articles 3 and 14 of Regulation 593/2008, the sale of receivables can be governed by a law different from that governing the receivable itself. This notwithstanding, where all other elements relevant to the situation at the time of the choice are located in a country other than the country whose law has been chosen, the choice of the parties shall not prejudice the application of provisions of the law of that other country which cannot be derogated from by agreement (i.e., the so-called “mandatory provisions”).

Moreover, Article 14.2 of Regulation 593/2008 establishes that the law governing the receivable shall determine (i) its transferability, (ii) the relationship between the assignee and the debtor, (iii) the conditions under which the assignment can be invoked against the debtor, and (iv) whether the debtor’s obligations have been discharged.

Likewise, some of the rights and obligations arising under promissory notes, bills of exchange and other types of negotiable instruments executed and delivered in Spain may not be submitted to the laws of a different country. Where the obligations arising under the receivables are secured by security interests on Spanish assets (for instance, a mortgage on real estate located in Spain), mandatory Spanish laws will apply to any such right in rem, and will govern, inter alia, the perfection and foreclosure of the security interest as well as the assignment thereof for the benefit of third parties.”

3.2 Example 1: If (a) the seller and the obligor are located in Spain, (b) the receivable is governed by the law of Spain, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Spain to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Spain, will a court in Spain recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Spanish own sale requirements?

Pursuant to Articles 3 and 14 of Regulation 593/2008, Spanish law would be, in principle, the law applicable to govern the contractual aspects of the sale agreement, as well as the conditions under which the assignment can be invoked against the obligor in this Example 1 (please refer to question 3.1 above). Thus, if the sale complies with the Spanish legal requirements for such purposes (please refer to questions 4.1 and 4.4), a Spanish court would recognise the sale as being effective against the seller and the obligor.

However, Regulation 593/2008 fails to regulate which law should be considered to determine whether the transfer of the receivables is enforceable vis-à-vis third parties (in fact, Article 27.2 of Regulation 593/2008 refers to a report to be prepared by the Commission on this topic as the basis for the amendment of Regulation 593/2008).

Having said that, taking into account the circumstances of Example 1 (all connected to Spain except for the location of the purchaser), the different solutions on this matter proposed by Spanish scholars in the past and the discussions in the context of the preparation of Regulation 593/2008, it is likely that a Spanish court would recognise the sale as being effective vis-à-vis third parties if the sale complies with the Spanish legal requirements for such purposes (please refer to question 4.2).

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Spain, will a court in Spain recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor and the enforceability of the transfer vis-à-vis third parties.

If the sale complies with the Spanish legal requirements for such purposes (please refer to questions 4.1 and 4.4), a Spanish court would recognise the sale as being effective against the seller and the obligor.

However, the fact that the obligor is located in a jurisdiction other than Spain (and in absence of additional development of the provisions of Regulation 593/2008) would make generally advisable the fulfilment of the legal requirements for purposes of enforceability of the transfer vis-à-vis third parties both under Spanish law and under the law of the location of the obligor, in order to ensure recognition by Spanish and obligor’s country courts.

3.4 Example 3: If (a) the seller is located in Spain but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Spain recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Spanish own sale requirements?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor and the enforceability of the transfer vis-à-vis third parties.

Thus, if the sale complies with the foreign legal requirements for such purposes, a Spanish court would recognise the sale as being effective against the seller (such requirements and foreign law need to be duly evidenced to the Spanish court).

However, the fact that the seller is located in Spain (and in absence of additional development of the provisions of Regulation 593/2008) would make generally advisable the fulfilment of the legal requirements for purposes of enforceability of the transfer vis-à-vis third parties both under Spanish law and under the law of the location of the obligor, in order to ensure recognition by Spanish courts.
3.5 Example 4: If (a) the obligor is located in Spain but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Spain recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Spanish own sale requirements?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor and the enforceability of the transfer vis-à-vis third parties.

Thus, if the sale complies with the foreign legal requirements for such purposes, a Spanish court would recognise the sale as being effective against the obligor (such requirements and foreign law need to be duly evidenced to the Spanish court).

However, the fact that the obligor is located in Spain (and in absence of additional development of the provisions of Regulation 593/2008) would make generally advisable the fulfilment of the legal requirements for purposes of enforceability of the transfer vis-à-vis third parties both under Spanish law under the foreign law, in order to ensure recognition by Spanish courts.

3.6 Example 5: If (a) the seller is located in Spain (irrespective of the obligor’s location), (b) the receivable is governed by the law of Spain, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Spain recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Spain and any third party creditor or insolvency administrator of any such obligor)?

Please refer to questions 3.1 and 3.2 as to the law applicable to contractual aspects of the assignment, the conditions under which the assignment can be invoked against the obligor and the enforceability of the transfer vis-à-vis third parties.

Thus, if the sale complies with the foreign legal requirements for such purposes, a Spanish court would recognise the sale as being effective against the seller (such requirements and foreign law need to be duly evidenced to the Spanish court).

However, as the seller is located in Spain and the receivable is governed by Spanish law (and in absence of additional development of the provisions of Regulation 593/2008), it would be generally advisable that the legal requirements for purposes of enforceability of the transfer vis-à-vis third parties both under Spanish law and under the foreign law are fulfilled, in order to ensure recognition by Spanish courts.

4 Asset Sales

4.1 Sale Methods Generally. In Spain what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Under Spanish law, receivables may be transferred from a seller to a purchaser in the following different ways, in all cases involving the execution of an agreement providing for the transfer of the receivable to the purchaser:

(a) ordinary assignment pursuant to the Spanish Commercial and Civil Codes;
(b) assignment pursuant to the 3rd Additional Provision of Law 1/1999, of 5 January, on Capital-Risk Entities; and
(c) assignment to a Spanish Asset-Backed Securitisation Fund (Fondo de Titulización de Activos, hereinafter “FTA”).

Although there is no common terminology, the above transactions will be customary referred to as receivables transfers (cesiones de crédito).

1. Ordinary assignment. Under the Spanish Commercial and Civil Codes, the seller remains liable before the purchaser for the existence of the receivable and for the validity of its legal title thereto, but it is not liable for the insolvency of the debtor, unless so agreed with the purchaser. It is thus possible to agree on sales with or without recourse, though in the absence of a specific provision thereon, there will be no recourse against the seller.

2. Privileged assignment. In accordance with the 3rd Additional Provision of Law 1/1999, a specific and more beneficial insolvency-related regime (please refer to question 6.3 below) will be applicable to those assignments of credits which, though generally structured as ordinary assignments, fulfil the following requirements:

(a) the seller is a business company (or an entrepreneur) and the receivables arise from its business activity;
(b) the assignee is a credit entity or a securitisation fund;
(c) the receivables exist at the time of execution of the receivables transfer agreement. However, the sale of “future” receivables is also allowed, provided that those receivables arise from the business activity of the seller within a maximum term of one year from the date of execution of the agreement or, otherwise, the future debtors are clearly identified in the agreement;
(d) the assignee pays to the seller, either upon closing or on a deferred basis, the consideration agreed for the receivables, less the costs of the services rendered (i.e., financing, collection, etc.); and
(e) where the assignment is agreed on a non-recourse basis, there is evidence that the purchaser has paid, in full or in part, the consideration for the receivables prior to the maturity of such receivables.

3. FTA. In accordance with Royal Decree 926/1998, of 14 May, on Asset-Backed Securitisation Funds, additional requirements apply to ordinary assignments made in favour of FTA, a form of regulated securitisation SPV which, subject to local registration, is allowed to issue asset-backed notes under insolvency-related privileged conditions (please refer to question 6.3). These requirements include the following, among others:

(a) the transfer of receivables must be agreed on a non-recourse basis to the seller, subject to no conditions, and for the remaining maturity of the receivables; and
(b) the seller cannot grant any kind of warranty (garantía) in favour of the purchaser nor guarantee the success of the transaction (asegurar el buen fin de la operación). Notwithstanding this, it is customary to agree on certain limited representations and warranties in order to ensure that the securitised portfolio conforms to the agreed eligibility criteria.

Finally, it is important to point out that recent legislation regarding the restructuring of the Spanish bank system (Act 9/2012, of 14 November and Royal Decree 1559/2012, of 15 November) has implemented a privileged regime for the sale of assets - including receivables - from the Sociedad de Gestión de Activos Procedentes...
4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

No special formalities are required in order for an ordinary or privileged sale of receivables (or for a sale to a FTA) to be effective between the contracting parties, though (a) the written form is customary, and (b) where the receivables result from a contract agreed in a public document, the parties may legally require that the assignment be executed also as a public document (though failure to do so does not affect the validity of the transfer amongst themselves).

Nevertheless, under Articles 1218, 1227 and 1526 of the Spanish Civil Code, certainty of the date of the transfer is required in order for it to be fully effective vis-à-vis third parties (for instance, in order to ensure that true sale treatment is achieved or for insolvency protection purposes). This certainty of the date of the transfer may be achieved, inter alia, by formalising the transfer in a public deed (escritura pública or policía intervenida) before a Spanish Notary Public.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

1. Payment instruments. Receivables represented by way of bills of exchange (letas de cambio), promissory notes (pagarés) and other analogous securities supporting abstract means of payment (efectos cambiarios) may be transferred by means of the physical delivery of the security document, followed (in the case of negotiable bills of exchange and registered promissory notes) by an endorsement, that is, a written and signed transfer statement issued by the seller in the title itself. Such means of transfer result in a full transfer of all rights attached to the relevant efecto cambiario, though not necessarily in a full transfer of the underlying receivable.

The issuance and transfer of efectos cambiarios is regulated by a special law, is specifically excluded from the application of Regulation 593/2008 and may involve the accrual of stamp duty (please refer to question 9.3).

2. Mortgage loans. The transfer of a single mortgage loan needs to be documented in a public document and registered with the relevant Property Registry. Otherwise, the transfer will be valid amongst the parties, but will not be effective vis-à-vis third parties and the foreclosure procedure may be severely limited. Similar requirements apply to the transfer of receivables secured with a chattel mortgage (hipoteca mobiliaria) or a pledge without displacement of possession (prenda sin desplazamiento de posesión). All the aforesaid transfers will generally involve the accrual of stamp duty (as the transfer is commonly documented by means of a public deed – escritura pública – that could potentially be recorded at a Spanish public registry).

The transfer by credit entities of mortgage loans meeting the eligibility criteria set forth in Section 2 of Law 2/1981, of 25 March, on the Mortgage Market, can be also perfected by means of the issue of mortgage certificates (participaciones hipotecarias). Where these mortgage loans fail to meet any of those criteria and provided that the purchaser is a qualified investor or an FTA, the transfer may be perfected by means of the issue of mortgage conveyance documents (certificados de transmisión de hipoteca). Participaciones hipotecarias and certificados de transmisión de hipoteca qualify as transferable securities.

In addition to a more favourable insolvency regime, the main advantage of this means of transfer of mortgage loans is that, under certain conditions, the issue of both participaciones hipotecarias and certificados de transmisión de hipoteca needs not to be documented in a public deed (escritura pública) or registered in the relevant Property Registries. They also benefit from a more favourable tax regime, as no stamp duty will accrue.

In any event, the seller/issuer of the certificates remains as the nominee and holder of record of the underlying loans in the corresponding Property Registries, but the holder of the certificates becomes the beneficial owner of the mortgage loan, subject to certain conditions that confer upon the transfer the “true sale” treatment.

3. Consumer loans. No special requirements apply for the sale of receivables when the obligors are consumers. However, Article 31 of Act 16/2011 requires that notice of the transfer is served on the consumer, where the seller ceases to provide servicing.

4. Debt securities. In addition to the assignment contract, those securities represented in book-entry form shall be transferred through an accounting record transfer. Those securities represented in registered form shall be transferred through the endorsement of the relevant title or under an ordinary assignment of receivables. Finally, those securities represented in bearer form shall be transferred by physical delivery of the title.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Unless it is otherwise stated in the receivables contracts, consent of the obligors is not required in order for the sale of receivables to be effective against the obligor. The parties may or may not serve notice of the sale on the obligor. If they choose not to do it, the obligor will be allowed to validly discharge its obligations by paying the seller (as original creditor). Likewise, the legal regime applicable to the obligor’s defences to challenge or object payment demands under the receivable varies depending on the date of the transfer and the date when transfer notice is served (for instance, the debtor’s right of set-off will apply to those seller obligations arising prior to the transfer notice, but not to those arising afterwards, unless the debtor explicitly approves the transfer). Accordingly, failure or delay in serving notice on the debtor may result in an increased number of valid objections against any payment demand filed under the transferred receivable.

If the receivable contract does prohibit assignment or requires the consent of the obligor and the latter is not obtained, many Spanish scholars maintain that the sale contract will remain valid amongst the parties to the sale agreement as a source of indemnity obligations, but...
will not be enforceable against the assigned obligors. Thus the receivables shall not be deemed transferred by the seller, who shall remain as the owner of the receivables. However, other scholars believe that the transfer of the receivables would be valid and enforceable against the obligor, who will be entitled to claim damages to the seller for the contractual breach. Spanish courts have failed to reach a definitive conclusion in relation to this matter.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no formal requirements regarding notification to the obligor, thus it may be executed by any means, by the seller or the purchaser. However, it is generally recommended: (a) to notify by any means that may later on be regarded as proof in court (i.e., notarial acta de notificación or certified mail with acknowledgment of receipt); and (b) to have the notice served by the seller.

No limitations apply regarding the purchaser notifying the obligor of the sale of receivables even after the insolvency of the seller or the obligor, without prejudice to the effects of the lack of notice in terms of discharge of the obligor and the obligor’s defences as set out in question 4.4, which shall be applicable as long as notice of the transfer is not served.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Spain? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Spain recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

In general terms, contractual restrictions to the sale or assignment of receivables are not prohibited under Spanish law.

If the receivable contract does prohibit assignment or requires the consent of the obligor and the latter is not obtained, the assigned obligors will not be given any right to sue the purchaser, particularly if the purchaser acted in good faith (i.e., was unaware of the existence of any such restriction). Please also refer to question 4.4 above.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Specific identification requirements are not applicable for the transfer of receivables, but generally stem from Spanish law principles which expect the parties to be able to identify the subject of any contract executed between them. Accordingly, no specific details need to be provided, other than those which allow the parties to identify, in clear and undisputable terms, the transferred receivables.

Where the receivables are to be transferred to an FTA, the rules require that the parties define the securitised assets (legally and financially) and provide details on matters such as outstanding balances, yields, financial flows, collection terms, amortisation schedule and maturity dates. Additionally, FTA’s regulations provide that assets to be transferred to an FTA must be of homogeneous nature. The interpretation of homogeneous nature is not completely clear and is analysed on a case-by-case basis by the CNMV. This homogeneous nature requirement does not apply to private FTAs.

Transactions where all existing receivables (or all receivables fulfilling certain conditions) are sold to the purchaser are generally valid under Spanish law but may face difficulties where necessary to prove effectiveness vis-à-vis third parties, as the above referred rules on identification apply as well. The same identification difficulties will apply to the sale of all the receivables of an entity other than the receivables owing by one or more specifically identified obligors.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Under Spanish law, contracts are to be interpreted not on the basis of the name or character that the parties wish to attribute to them (for instance, in the name or the headings of the different clauses), but rather on the basis of the actual legal nature of the terms and conditions agreed thereunder. Thus, if the parties regard a transaction (for instance, by using that term in the headings or in the contents) as an assignment or other form of “true sale”, but the terms and conditions thereof and, in particular, its real intent (causa), suggest otherwise (for instance, a form of security), a court is allowed to recharacterise the transaction as per its genuine nature. Generally the courts have upheld the true sale treatment of the sale of receivables, irrespective of the parties agreeing to such transfer on a recourse or non-recourse basis, but always provided that the purchaser advances all or part of the funds agreed as consideration for the transfer of the receivable (in other words, where such transfer is agreed in terms such that the acquirer does not advance any funds, does not bear the risk of the receivable, and is thus used for collection purposes only; the transfer shall not be treated as a true sale). This having been said, in the past, in conferring true sale treatment to any given transfer, the courts have been constrained by the courts (for instance, in certain minority rulings on factoring agreements entered into by credit institutions) as an evidence that the transfer ought not to be treated as a sale, but rather as a collateralised loan granted by the purchaser.

The fact that the parties agree to vest upon the seller collection responsibilities does not alter the above views (by way of example,
where the sale of purchase is an FTA, collection responsibilities shall be retained by the seller unless otherwise agreed).

In addition to the above, legal characterisation or effects of a particular transaction is not necessarily coincident with its treatment under other conditions. For instance, Spanish accounting and capital adequacy rules applicable to credit entities focus on certain terms of the transaction (mainly credit risk retention) to determine whether a sale of receivables can benefit from off-balance sheet treatment.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes, though the effectiveness vis-à-vis third parties depends on the need to provide proper identification, as well as execute a public document each time new receivables are transferred. However, the efficacy of this commitment in an insolvency scenario may be restricted in several ways.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow securitisation”)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

1. Ordinary assignment. Although it is generally accepted that the transfer of future receivables may be validly agreed upon by means of an ordinary assignment, the scholars and the courts have failed to reach a common view on whether the acceptance by the purchaser (or any other formal requirement, such as the notice to the debtor) upon each receivable effectively coming into existence is necessary (thus casting a shadow of doubt on the efficacy of any such transfer until such time), or if the purchaser is ab initio the owner of such receivables from the moment they arise. It is thus advisable to ensure that periodic transfers are executed in public documents.

2. Privileged assignment. The transfer of future receivables is allowed, provided that those receivables arise from the business activity of the seller within a maximum term of one year from the date of execution of the agreement or, otherwise, the future debtors are clearly identified in the agreement (please refer to question 4.1 above).

3. FTA. Existing FTA regulations allow the securitisation of future receivables to the extent, amongst other requirements, that they produce a flow of income of an already known or estimated amount. Among the types of future receivables which are eligible for such a transfer, the FTA regulations include lease rentals, flows arising out of toll road projects, flows resulting from public concession contracts, IP rights, etc. Pursuant to Orden EHA/3536/2005, of 10 November, the transfer of future receivables in favour of an FTA shall fulfil the following requirements (i) the transfer must be full and unconditional (plena e incondicionada), and (ii) the incorporation deed of the FTA must include (a) the terms of the agreement or activity which will generate the future receivables, (b) the powers of the seller over those future receivables transferred, (c) the terms and conditions of the transfer, and (d) the risk allocation between the seller and the purchaser of the receivables. Please refer to questions 6.1 and 6.5 below on the treatment of receivables arising prior to, or after, the declaration of insolvency.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

In general terms, the sale of a receivable entails the automatic transfer of all rights accessory to such receivable, such as personal guarantees (fianzas), pledge, mortgage or other privileges (unless otherwise agreed by the relevant guarantor). However, please refer to question 4.3 as to the specific conditions for the sale of mortgage loans. Furthermore, for the transfer of security to be effective vis-à-vis the guarantor, notice should be served. Similarly, the terms of the accessory rights should be reviewed as they may provide for additional requirements.

5 Security Issues

5.1 Back-up Security. Is it customary in Spain to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Such practice is not customary in Spain.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Spain, and for such security interest to be perfected?

Receivables can be subject to an ordinary pledge, a pledge without displacement of possession or a financial guarantee. Spanish national legal regime (described below) applies generally to these securities but, depending on the location of the pledged object, regional regulations may also be applicable. The benefit of a security interest perfected over a receivable will also extend to any related security (please refer to question 4.11 above). In addition, under certain limited circumstances, additional security interests may be perfected over existing security interests (e.g., perfecting a mortgage over a pre-existing mortgage or perfecting a pledge over the rights stemming from a pre-existing pledge or a personal guarantee (fianza)).

1. Ordinary pledge. A “displacement of the possession” of the pledged asset is required in order for the pledge to be valid. Although it is not clear how this dispossession requirement is to be interpreted when the object of the pledge is a receivable (i.e., an intangible asset), some scholars understand that the displacement of possession is effected through the notice to the debtor, while others (as well as Spanish insolvency rules) maintain that the mere agreement of the parties is sufficient for validity purposes, with no need to notify the obligor.

In order to ensure that the ordinary pledge is enforceable and effective vis-à-vis the obligor and any other third party, the pledge needs to be executed in a public document (escritura pública or póliza intervenida). The pledge needs not to be registered in any public registry. However, in case of insolvency of the pledgor, the special privilege for claims secured with ordinary pledges and generated after the insolvency declaration is subject to discussion following an amendment to the Spanish insolvency law in October 2011. The aforesaid amendment has been, for most of the scholars, very controversial and its interpretation should be clarified by
2. Pledge without displacement of possession. In order for the pledge without displacement of possession to be valid, it shall be duly registered with the relevant movable assets registry (Registro de Bienes Muebles) and shall be executed in a public document (escritura pública o póliza intervenida). In practice, this type of pledges are documented by means of a póliza intervenida in order to avoid certain tax costs (please refer to question 4.3 above) and are becoming increasingly usual as they benefit from a more certain insolvency treatment than ordinary pledges (following an amendment to the Spanish insolvency regime in October 2011).

3. Financial guarantees. Following a reform of the Spanish legal regime applicable to financial guarantees (i.e., those resulting from the implementation in Spain of the Directive 2002/47/EC, of 6 June, on financial guarantees), certain receivables held by credit institutions may be the object of financial guarantees in the form of pledge or repos (such securities benefiting from the privileged legal regime applicable to financial guarantees in terms of, inter alia, perfection, enforcement and insolvency).

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Spain to grant and perfect a security interest in purchased receivables governed by the laws of Spain and the related security?

As per Article 14.3 in Regulation 593/2008 (please refer to question 3.4 above), the principles set out in this rule are expected to apply to any form of assignment by way of collateral. Accordingly, the concept of “assignment” includes “not only outright transfers of claims, (but also) transfers of claims by way of security and pledges or other security rights over claims”.

Generally speaking, provided that the applicable conflict of law rules are complied with, the granting of a security interest under a foreign law would be treated as valid and perfected in Spain.

As mentioned above, Regulation 593/2008 leaves open the question of the enforceability of the sale vis-à-vis third parties (see Article 27(2)). It is therefore not fully clear which law should govern the effectiveness of a pledge of receivables as against other creditors of the seller, insolvency administrators or even third parties alleging a priority legal title on the relevant pledged receivables. In the meantime, it is generally advisable that, when enforceability of a pledge vis-à-vis third parties is expected to be sought before a Spanish court (for instance, in the context of an insolvency of a Spanish-based pledgor or where the obligor is located in Spain), Spanish law perfection requirements be met as well. Under Spanish law, a security interest over receivables (either formalised as an ordinary pledge, as a pledge without displacement or a financial guarantee) is generally a right in rem. Spanish Civil Code provides that rights in rem over assets located in Spain must be governed by Spanish law. Location of receivables is not a clear-cut issue, but to the extent that receivables are deemed located in the country of the law governing the receivable, or where the seller or obligor operate, and the country of the purchaser is different from those, Spanish courts may refuse enforcement of the pledge, even if requirements for the validity and perfection of the security interest have been followed.

Notwithstanding the above, it must be noted that Spanish regulations implementing the Directive 2002/47/EC, of 6 June, on financial guarantees have been amended and now expressly provide that, when the object of the financial guarantee is receivables (please refer to question 5.2 above), the law governing the enforceability of the financial guarantee vis-à-vis third parties shall be the law governing the underlying receivable which is the object of the guarantee. Although it is true that this provision refers to a very specific security interest, it cannot be discarded that Spanish courts make, in the absence of any other Spanish or EU legal provision on this matter, an analogous interpretation of this rule and apply it to other type of security interest over receivables and even to the enforceability of receivables transfers vis-à-vis third parties.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

In addition to those requirements set forth in question 5.2, the granting of security interests on each of those assets require the following:

1. Mortgage loans. Under Spanish law, the creditor in a mortgage loan may grant an additional mortgage on its right of credit (the so-called “mortgage on the mortgage” or “sub-mortgage”). This mortgage needs be executed in a public deed and registered in the relevant Public Registry.

2. Promissory notes and marketable debt securities. Where those securities have been represented in book entry form, the creation of a pledge needs to be registered in the relevant registry to ensure effectiveness vis-à-vis third parties. If the securities have been issued in registered form, the securities must be delivered to the beneficiary-pledgee and the pledge needs be registered in the relevant certificate by way of an “endorsement for guarantee purposes”. If the securities have been issued in bearer form, the securities must be delivered to the beneficiary-pledgee.

3. Insurance policies. No specific requirements are applicable for the granting of security interest over rights arising out of insurance policies. However, in case of creation of any security interest over assets which are insured against damages, the scope of the security shall be extended to the indemnities recovered by the insured party as a consequence of an insured event (for such purpose, the insurance company must be served notice of the creation of the security).

5.6 Trusts. Does Spain recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

The concept of “trust” is not one which is regulated and/or fully recognised (i.e., generally accepted by Spanish courts) under Spanish law and practice. It is therefore not usual to find trusts used as a means to ensure that flows resulting from the assigned receivable and temporarily held by the seller are kept legally isolated from the rest of the seller’s assets. However, similar effects may be achieved through a pledge over the bank account where the collections received by the seller are credited, securing the seller’s
obligations vis-à-vis the purchaser. Such a pledge would in principle create a special privilege in favour of the purchaser over the balance of the account, either in an insolvency or non-insolvency situation (although claims of the purchaser arising after the insolvency declaration might face difficulties to be recognised as privileged claims in light of the current regulations). Moreover, special arrangements with the credit entity where the account is opened could be implemented so that, upon the occurrence of a specified insolvency event on the seller, disposal instructions need to be received from the purchaser.

5.7 Bank Accounts. Does Spain recognise escrow accounts? Can security be taken over a bank account located in Spain? If so, what is the typical method? Would courts in Spain recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Spain?

Bank accounts opened in the name of a given party, but where disposal by its record holder is limited, blocked or otherwise conditioned to the occurrence of a specific event, the consent or instructions of a third party or any other circumstance, are legally admissible and market practice under Spanish law. Moreover, security can be taken over receivables arising out of a bank account located in Spain, through an ordinary pledge or a pledge without displacement (please refer to question 5.2 above for more details on these types of securities). Pledge over bank accounts can benefit from a specific privileged regime (especially when it comes to enforcement and in case of insolvency of the seller) if certain conditions in relation to the nature of the parties to the pledge and the secured obligations are met.

In cases where a bank account is located in Spain (i.e., it is opened in a Spanish office of a credit entity), receivables deriving thereunder shall most likely be understood as located in Spain and, as a result, Spanish courts may refuse enforcement of a foreign law pledge which has not been perfected as per applicable Spanish rules (please refer to question 5.4 above for more details on this issue).

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

If a pledge over the balance of a bank account from time to time has been created, the secured party will generally be entitled to appropriate such balance as per the enforcement rules agreed. If the bank account is held in the same bank which is secured by such pledge, the secured creditor will generally have the right to set-off. Enforcement of these pledges following an insolvency declaration may face different restrictions.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, if the security has not been enforced, the parties may agree on a regime allowing for the restricted or even unlimited use of funds by the debtor. That said it is not unusual to establish a symbolic minimum amount that must remain at all times, on the bank account (so that the balance is always positive), since some scholars argue that in case that the balance of the bank account is zero or negative at any time (and thus no credit derives from the bank account – i.e., there is no object for the pledge), the security could be interpreted as automatically cancelled.

Additionally it is contractually possible to limit the faculties of the holder of the bank account over it either from the execution of the pledge or following a specific event (i.e., an event of default), although an amendment of the bank account agreement (and therefore, consent from the depositary bank) would be needed.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Spanish insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Sale of receivables. No stay of action would be applicable under Spanish insolvency regulations. Where the transferred receivables have been properly identified, the purchaser should be allowed to continue collecting and exercising ownership rights over the transferred receivable. If not done already, the purchaser is allowed to serve notice of transfer on the obligors. Additional transfers (e.g., in the context of a sale of future receivables or a continuous sale of receivables) may be delayed or even suspended. Funds held for credit by the seller (e.g., collection monies) for the account of the purchaser, may be subject to insolvency proceedings (commingling risk).

As a matter of practice, though, where administration of receivables is still being conducted by the seller (and therefore some acts by the seller are necessary so that the purchaser may continue to collect the receivables), it cannot be discarded that the insolvency officials dispute the need to continue serving the receivables and/or that specific arrangements are put in place to allow collection funds to be paid out of the insolvency proceedings.

Pledge of receivables. Unless the foreclosure proceedings have reached certain stages before the insolvency proceedings have started, the enforcement of security interests over assets owned by the seller and used for its professional or business activities will be stayed following the declaration of insolvency until the first of the following circumstances occurs: (a) approval of a creditors’ composition agreement (unless the content has been approved by the favourable vote of the purchaser as secured creditor, in which case it will be bound by the composition agreement); or (b) one year has elapsed since the declaration of insolvency without liquidation proceedings being initiated. There is general controversy on whether a pledge on a portfolio of receivables would qualify as a security on assets “used for its professional or business activities”.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Please refer to question 6.1 above.
6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvent official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Spain for (a) transactions between unrelated parties and (b) transactions between related parties?

Pursuant to the general regime set forth under the Spanish insolvency law, upon the insolvency of a Spanish party (an entity or an individual) being declared:

(i) those actions which are judged detrimental to the estate of the insolvent party and which have been carried out during the two years preceding such date, may be rescinded even in the absence of fraudulent intention;

(ii) the detriment to the estate is presumed iuris et de iure (i.e., without possibility of providing evidence to the contrary) in the case of actions of disposal without consideration (except for usual liberalities), and payments or other actions aimed at discharging obligations with an original date of maturity subsequent to the date of the insolvency declaration, except where the discharged obligation is secured with an in rem right, in which case paragraph (iii) (c) below shall apply;

(iii) furthermore, detriment is presumed iuris tantum (i.e., unless evidence is provided to the contrary) in the event of: (a) disposal actions carried out in favour of a party related to the insolvent party; (b) the creation of in rem guarantees (security interests) for the benefit of pre-existing obligations or of new obligations replacing previously existing ones (except for refinancing transactions where certain conditions are met); and (c) payments or other actions aimed at discharging obligations secured with an in rem right with an original date of maturity subsequent to the date of the insolvency declaration;

(iv) in the case of actions not included in any of the above two categories, the detriment must be proven by the person bringing the action of rescission (e.g., the insolvency official);

(v) ordinary actions taken by the debtor as part of the ordinary course of business under normal conditions shall not be subject to clawback actions described in paragraphs (i) to (iv); and

(vi) notwithstanding the above, actions of rescission will not be available in the event that the beneficiary of the detrimental action proves that such a transaction is governed by a foreign law which does not permit its rescission in any case.

This general regime applies to the sale of receivables benefiting from the ordinary and privileged regimes. Notwithstanding, where the sale of receivables is made in favour of an FTA, such sale shall not be rescindable unless evidence is given of the fact that fraud existed at the time the assignment was made.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvent official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Such consolidation should not be carried out under normal circumstances. Spanish law does not contemplate “substantive” consolidation in an insolvency scenario, other than in respect of certain procedural matters and in situations where purchaser and seller are closely related parties (e.g., member of the same group) and the respective estates cannot be separated, under the terms of Chapter III of the Spanish insolvency law.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Spain, what effect do those proceedings have (a) on sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Where an agreement has been entered into by the seller and the purchaser for the sale of the seller’s future receivables arising out of contracts, as specified or generally described in the sale agreement, and the seller is declared insolvent, the general principles should provide for the need to ensure that the transfer is generally respected and that the receivable arises in the estate of the purchaser, even in the context of an insolvency of the seller. However, this matter remains a disputed issue under Spanish law, i.e., whether the receivables arising after the declaration of the insolvency situation must be subject to the insolvency or directly arise as part of the purchaser’s estate, thus being left outside of the seller’s insolvency estate. Though the court precedents are scarce and not yet definitive, it is generally accepted that “privileged” transfers of future receivables (please refer to question 4.1) should be upheld by the insolvency officials and the judge.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Spain establishing a legal framework for securitisation transactions? If so, what are the basics?

Standard, market-oriented securitisation transactions are structured through FTAs, and their close relatives, Mortgage-Backed Securitisation Funds (Fondos de Titulización Hipotecaria, hereinafter, “FTH” and together with FTA, the “Funds”), where specially defined mortgage loans are securitised. Those Funds are the standard vehicles designed by the Spanish legislator to develop the local market for securitisation transactions aimed at the general public. Additionally “private” securitisation (i.e., non-listed transactions addressed to qualified investors) are allowed under the FTA/FTH format, provided that the relevant ABS/MBS bonds will not be listed in the Spanish regulated markets.

A Fund is defined as a separate estate that lacks legal personality (personalidad jurídica) and is represented by the managing company. Therefore, all actions taken by, and all agreements, transactions or arrangements entered into by the managing company on behalf of the Fund will be deemed, under Spanish law, to be actions taken and agreements, transactions or arrangements entered into by the Fund.

1. Assignment of receivables to an FTA

Please refer to questions 4.1, 4.2 and 4.10 above for a discussion on the conditions for the assignment of receivables to an FTA.

2. Types of FTA

Closed funds. The assets transferred thereto and the liabilities thereof will not be modified as from the date of the incorporation of the Fund, without prejudice to possible replacements in certain cases, such as the existence of non-eligible assets. FTH shall be closed funds.

Open funds. The assets of the fund, or its liabilities, or both of them, may be modified (renewed) and/or extended after the incorporation of the Fund. For instance, new assets may be assigned to the FTA or new notes issued to finance the existing portfolio.
3. Funding of the FTA

Fixed income securities. The total amount of the securities issued must be above 50 per cent of the total liabilities. The financial risk of the securities issued must be rated by a rating agency recognised by the Spanish Commission for the Securities Market (Comisión Nacional del Mercado de Valores; hereinafter “CNMV”) for such purposes.

The securities are issued under the terms of the incorporation public deed of the Fund. Unlike other markets, there is no such thing as a trustee; the bondholders will be represented by the managing company and they will not have any individual right other than the claim against the Managing Company/Fund for breach of the relevant contracts and legal duties.

Loans granted by credit institutions. Contributions by qualified investors (Inversores Institucionales), such as credit institutions, insurance companies, certain investment firms and other types of schemes and investment entities established under Spanish laws, which will have rights on the residual value of the Fund.

4. Incorporation of an FTA

The basic requirements (some of which may be exempted) are the following:
- Previous communication to the CNMV.
- Informative Prospectus (Offering Circular), which must be registered with the CNMV and examined thereby; the Prospectus will not be required in the event that the issue is addressed to institutional investors and the relevant bonds will not be listed in the Spanish regulated markets.
- The securitised receivables must be audited by an auditor.
- Formalisation of a public deed of incorporation before a Spanish Notary Public.

5. Managing company

A Spanish managing company of securitisation funds (Sociedad Gestora de Fondos de Titulización) duly incorporated and authorised by the CNMV, will be responsible for the incorporation, management and representation of the FTA. The managing company will be empowered with any rights conferred upon the Fund as holder of the securitised portfolio of assets.

7.2 Securitisation Entities. Does Spain have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Please refer to question 7.1 above.

Funds enjoy a special treatment in relation to some legal aspects, such as clawback provisions in case of insolvency of the seller or a special tax regime, which are analysed in other questions of this chapter.

As Funds are not legal entities, they do not have shareholders or directors; however, shareholders with a significant stake in a management company (basically, more than 10 per cent) need to meet certain individual suitability standards, and members of the board of directors need to be honourable, the majority of them having to be experienced.

7.3 Non-Recourse Clause. Will a court in Spain give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

A Spanish court would, in principle, give effect to a contractual provision whereby one of the parties agrees to limit recourse to a limited number of the other party’s assets.

7.4 Non-Petition Clause. Will a court in Spain give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Voluntary waiving of rights recognised by law shall not be valid if deemed to be contrary to public order, or made to the prejudice of a third party; furthermore, under Spanish law, waiver of future rights not yet existing or of pure expectations could be deemed null and void, unless ratified at the time of the existence of the rights. The right to bring action where in the presence of fraud or wilful misconduct cannot be validly avoided by the parties. Further, a full and unconditional waiver of any action may be found to lack any cause and be held invalid.

As for the non-insolvency clauses, they may be validly agreed upon by the parties, though no such clause will have any efficacy vis-à-vis third parties. Even if the contractual provision was deemed valid and effective, it is most likely that the court would admit the legal action or the application of insolvency, without prejudice to the effects among the parties that such contractual breach could bring.

7.5 Priority of Payments “Waterfall”. Will a court in Spain give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Waterfall schemes will be generally respected unless conflicting with mandatory provisions of Spanish law. Similarly, waterfall schemes should be expected to be scrutinised by the insolvency officials and be rejected to the extent leading to a prejudice for the Spanish debtor or infringing other Spanish insolvency rules.

7.6 Independent Director. Will a court in Spain give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in the party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Spanish directors are bound by fiduciary and other legal duties including, among others, the duty to seek for insolvency protection where legally required. Failure to comply with those duties will expose the directors to direct and immediate legal responsibility vis-à-vis the company and its creditors, among others.

8. Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Spain, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Spain? Does the answer to the preceding question change if the purchaser does business with other sellers in Spain?

In principle, the only activity reserved to credit institutions in Spain...
is the gathering of reimbursable funds from the public (deposits) on a general basis. Therefore, the business of acquiring existing portfolios of receivables is not generally regarded as one requiring prior administrative authorisation as a financial entity. Locally incorporated Funds and its Managing Companies are subject, among other legislation, to certain Spanish capital market regulations and CNMV’s surveillance.

Servicing and administration of the assigned receivables does not itself entail the need to obtain a local licence. However, to the extent that the actual activities within the scope of the administration fall within the scope of a regulated sector (e.g., insurance mediation), a local licence may be required.

Additionally, as a general rule, the assistance of a court representative (procurador) and a lawyer is required to appear in courts.

8.3 Data Protection. Does Spain have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes. Organic Law 15/1999, of 13 December, on Personal Data Protection (and other implementing and related regulations, such as Royal Decree 1720/2007, of 21 December), restricts the use and dissemination of personal data of individual obligors. In order for a personal data controller to use and/or transfer personal data to a third party legally (regardless of whether the third party is located in Spain or abroad), the data subject must be informed, before or upon the process and/or transfer, of the processing that will be carried out and/or the circumstances of the transfer (which includes, among others, the identification of the recipient(s)), and additionally, the process and/or the transfer must rely on a “legitimate ground” listed in the law (e.g., when the process or transfer is authorised by law or when the data subject’s consent has been obtained). The controller’s legitimate interest has been recently considered as a “legitimate ground”, however, its application is limited at this moment.

In certain cases in which the data is transferred to a country outside the European Economic Area whose regulations, as identified by the European Commission or the Spanish Data Protection Agency, do not afford an adequate level of protection, then the controller must obtain the Spanish Data Protection Agency’s prior authorisation, unless the transfer relies on one of the exemptions thereto exhaustively listed in the Spanish regulations (e.g., when the prior and unambiguous data subject’s consent to process his/her personal data in such country has been obtained).

As a general rule, Organic Law 15/1999 does not apply to data of enterprises (with the exception of sole traders that may be considered as “individuals” for data protection purposes). In any case, other rules (for instance, banking secrecy and contractual confidentiality duties) may hinder the ability of a seller/purchaser to disclose in a publicly available document (e.g., a prospectus) key data of the assigned debtor.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Spain? Briefly, what is required?

No. However, if the receivables assigned to the purchaser are subject to Act 16/2011, the consumer-obligor of the receivable must be informed of the transfer (except in case the seller keeps providing servicing) and the consumer-obligor may exercise against the purchaser the same exceptions which he could exercise against the seller (including the right to set-off).

8.5 Currency Restrictions. Does Spain have laws restricting the exchange of Spanish currency for other currencies or the making of payments in Spanish currency to persons outside the country?

No restrictions are imposed to the transfer of receivables from the seller to a foreign purchaser. However, since these kinds of transactions may be construed as financing structures, similar to loans granted by foreign entities to domestic non-banking companies, it is necessary to obtain a financial transaction number (número de operación financiera or NOF) from the Bank of Spain, provided that the amount of the transaction exceeds Euro 3,000,000.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Spain? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Income obtained by the non-Spanish resident purchaser on the difference between (i) the payments made by the obligors, and (ii) the purchase price paid by the purchaser to the seller (i.e., taking into consideration any agreed discount) may be regarded by the Spanish tax authorities as either Spanish source interest income or as capital gain. To the best of our knowledge, there are no rulings issued by the Spanish tax authorities or the Spanish courts on the subject of the transfer of receivables and its classification for Spanish direct income tax purposes.

However, under an internal exemption of the Non-Resident Income Tax, income obtained by the purchaser, regarded either as interest or as capital gains, will not be subject to Spanish tax to the extent that the purchaser (i) is resident of a Member State of the European Union for tax purposes and may obtain and submit a certificate of tax residence issued by the relevant tax authorities of its country of residence, (ii) does not act with respect to the transaction through a permanent establishment located in Spain or outside the European Union, and (iii) does not act through a territory regarded as a tax haven jurisdiction for Spanish tax purposes.

Regarding interest paid by the obligor to the seller if the latter is a Spanish company, it will be typically subject to a 19 per cent (21 per cent for calendar year 2013) withholding tax (this does not apply to a recipient which is a financial entity). Indeed, since the assignment of the receivable is not disclosed to the obligor, the obligor will assume that the payment is due to the Spanish seller, and that the withholding tax is due i.e., the tax is levied on the Spanish seller, not on the purchaser.
9.2 Seller Tax Accounting. Does Spain require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

A Spanish seller will need to follow the Spanish GAAP on de-recognition of financial assets. This rule focuses on the existence of an actual transfer of risk and benefits by the seller to the purchaser and is in line with the International Accounting Standards adopted by the European Commission. The tax law will follow the accounting rule in this matter.

9.3 Stamp Duty, etc. Does Spain impose stamp duty or other documentary taxes on sales of receivables?

Stamp duty will be levied upon the issuance of those Spanish receivables which credit right is evidenced by bills of exchange (letras de cambio), promissory notes (pagarés), or other draft documents in which the document has the purpose of transferring funds (título-valor, documento cambiario o instrumento con función de giro), on the basis of its amount and its maturity.

However, registered promissory notes which are issued on a non-endorsable basis (pagarés nominativos no a la orden) will not be subject to stamp duty unless, pursuant to Article 33 of the Transfer Tax and Stamp Duty Law, they are issued as part of a series, with a maturity shorter than eighteen months and with a consideration represented by a discount over the face value. This notwithstanding, in such a case, these notes will benefit from the exemption regulated in Article 45.I.B) 15 of the Transfer Tax and Stamp Duty Law.

In general terms, stamp duty will be levied at the issuance of the draft document rather than as a consequence of its transfer. However, any person that intervenes in connection with the circulation of the draft documents, including the purchaser, will be joint and severally liable with the issuer of the instrument for any unpaid stamp duty.

9.4 Value Added Taxes. Does Spain impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

In accordance with Spanish law, a sale of receivables, as any transfer of credits, is subject to, but exempt from VAT, to the extent the transfer of credits by the seller to the purchaser is made without recourse and, consequently, the seller does not assume the risks of insolvency of the debtors.

In principle, under Spanish VAT Law, collection services receive a different tax treatment than that applicable to the transfer of credit with or without recourse. Therefore, there would be grounds to maintain that the collection services provided to the purchaser should be subject to VAT since collection services do not benefit from the VAT exemption set forth in the VAT Law for transfer of credits without recourse (Article 20.1.18.e of the VAT Law).

However, under the general rule contained in Article 69.1 of the VAT Law concerning the place from where the supply of services is deemed to be rendered for VAT purposes, collection services are deemed to be supplied in the state where the customer has established its business, or has a fixed permanent establishment to which the service is supplied, or, in the absence of such place, the place where it has its permanent address or usually resides.

Thus, if the entity to which the services are supplied (i.e., the purchaser) is not established in Spain for VAT purposes, the services will not be deemed to be supplied in Spain and, therefore, will not be subject to Spanish VAT.

Having said the above, if the agreement entered into by the seller and the purchaser qualifies as a factoring agreement, there would be a range of services deemed to be rendered for VAT purposes by the purchaser to the seller (namely, financial services, management and collection services and, if applicable, a guarantee services). In particular, the management and collection services, and the guarantee services, would be subject to and not exempt from Spanish VAT and the seller should assess the VAT due on that transaction given that the supplier of the service (i.e., the purchaser) is not established in the Spanish VAT territory. Additionally, the delivery of the receivables by the seller to the purchaser will not qualify as a VAT taxable transaction and will be disregarded for any VAT purposes (including for purposes of assessing the entitlement of the seller to deduct any input VAT borne).

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

Following Spanish VAT Law, recipients of the supplies of goods and services might be liable for the unpaid VAT under certain circumstances. That is the case of those recipients of goods or services which, through any intentional acts or omissions, avoid the correct chargeability of the VAT.

Likewise, any purchaser of goods might be liable for any unpaid liability triggered on prior acquisitions of the same goods acquired when the goods were purchased for a price lower than the market value, if the acquirer should have presumed in light of the relevant evidences that the VAT corresponding to the previous supply of the same goods was not paid. Finally, there are a number of cases where entities acting in the name of the importer (either as an agent or as a representative) might be liable for VAT not paid by the importer.

As it could be followed, the role of the purchaser (limited to the acquisition of receivables from the seller) should not lead to this entity becoming liable for any VAT not charged or unpaid by the seller in its commercial dealings with the obligors.

In addition, General Tax Law allows the tax authorities to claim the payment of taxes to entities or individuals other than the taxpayer (the seller) when such Spanish tax authorities understand and provide evidence of (i) the collaboration of the purchaser in the tax law infringement, or (ii) the transfer of a business activity to the purchaser as an on-going concern (which would not be applicable in a sale of receivables).

9.6 Doing Business. Assuming that the purchaser conducts no other business in Spain, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Spain?

In such an scenario, the seller may constitute a permanent establishment of the purchaser in Spain (and thus, subject to Spanish taxation), if the seller, in its condition as services provider, acts as an agent of the purchaser with the right to enter into agreements with third parties e.g., the obligors, on behalf of the purchaser.
This would typically not be the case. Nevertheless, in order to exclude the risk of a permanent establishment, the seller should not be provided with any powers of attorney of relevance with respect to the purchased receivables (e.g., contemplating the right to forgive, set-off, reduce or postpone collection of the receivables), but only with the faculties related to the cash collection of the receivables.

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Chapter 37

Switzerland

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

In order to create an enforceable debt obligation of the obligor, it is not required that the sales of goods or services are evidenced by a formal receivables contract. Under the contract rules of the Swiss Code of Obligations (CO), a contract may not only be entered into in writing, but also orally or based on implied conduct of the parties (behaviour). By taking the parties’ conduct into account, an invoice may constitute evidence of a contract.

1.2 Consumer Protections. Do Switzerland’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

The Swiss Consumer Credit Act and its implementing ordinance provide that the maximum interest rate (including commissions and other costs) for consumer credits (typically loans) may not exceed 15 per cent per annum. Outside the applicability of the Consumer Credit Act, federal case law provides for a maximum interest rate of 18 per cent per annum.

If an obligor is in default in discharging the receivables of the seller, the receivables bear a default interest of 5 per cent per annum (Art. 104 CO).

The obligor has the right to cancel the consumer credit (loan) within 7 days after the conclusion of the consumer credit contract. Cancellation must be made in writing. Another noteworthy right of the consumer is that claims for payment against consumers may only be brought before the competent court in the country of residence of the consumers.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

There are no different requirements and laws relating to receivables of the government and government agencies. However, receivables against the government and government agencies relating to public assets (Verwaltungsvermögen) are protected against enforcement by third parties. Receivables relating to private assets (Finanzvermögen) of the government and government agencies, on the other hand, are not immune against enforcement.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Switzerland that will determine the governing law of the contract?

The Swiss Statute on Private International Law (PIL) of 18 December 1987 provides that, in the absence of an explicit choice of law, the contract will be governed by the law of the state with which it is “much closely connected” (Art. 117 para. 1 PIL).

It is presumed that the closest connection exists with the state where the party called upon to provide the ‘characteristic performance’ of the contract has – at the time of conclusion of the contract – its ordinary residence or, if the contract was concluded in the exercise of a professional or commercial activity, where such party has its place of business. In particular, the following shall be considered the characteristic obligation:

(a) the obligation of the alienator, in contracts of alienation;
(b) the obligation of the party transferring the use of a thing or a right, in the case of contracts concerning the use of a thing or a right;
(c) the service performed, in the case of mandates, work and labour contracts, and similar service contracts;
(d) the obligation of the custodian, in custodial contracts; and
(e) the obligation of the guarantor or the surety, in guaranty or surety contracts.

There are specific provisions regarding certain types of contracts that precede these rules as leges speciales. In particular the following contracts are involved:

The sale of movable property is governed by The Hague Convention of 15 June 1955 on the Law Applicable to International
Sales or Movable Property. However, this provision shall not apply within the scope of the United Nations Convention on the International Sales of Goods (CISG) of 11 April 1980, if the application has not explicitly been excluded by the parties (see question 2.4 below).

Contracts concerning real property (or its use) are basically governed by the law of the state in which the property is located. A choice of law by the parties is permitted. However, it has to be noted that the form of the contract is governed by the law of the state in which the real property is located unless that law permits the application of another law. In case of real property located in Switzerland, the form shall be governed by Swiss law.

Contracts for a performance relating to normal consumption, which is intended for a consumer’s or for his family’s personal use and not connected with his professional or commercial activities, are governed by the law of the state in which the consumer has ordinary residence if (i) the offeror has received the order in that state, (ii) in that state, the conclusion of the contract was preceded by an offer or advertisement and the consumer has carried out the legal acts necessary for the conclusion of the contract in that state, or (iii) the offeror has prompted the consumer to go abroad and deliver his order there. In such cases, a choice of law by the parties is excluded.

Employment contracts are governed by the law of the state in which the employee has his ordinary place of work. If the employee ordinarily works in several states, the employment contract is governed by the law of the state in which the employer’s business establishment or, in the absence of such establishment, his domicile or ordinary residence, is located. However, the parties may subject the employment contract to the law of the state in which the employer has his ordinary residence, or in which the employer has his business establishment, domicile, or ordinary residence.

Contracts concerning intellectual property are governed by the law of the state in which the party transferring the intellectual property right or granting the use thereof has its ordinary residence. A choice of law is permitted. However, contracts between employers and employees in the course of performance of the employment contract shall be subject to the law governing the employment contract.

The Swiss PIL is based on the general principle of the parties’ autonomy to contract. This principle includes the right of the contracting parties to freely choose the governing law. For the purpose of this general principle, the Swiss PIL provides that contracts are subject to the law chosen by the parties (Art. 116 para. 1 PIL). This applies also where only one of the parties is located Switzerland and the parties chose the foreign law of the party located outside Switzerland.

However, there are several general restrictions and limitations to the right to freely elect the governing law under Swiss law:

(a) First, the election of a foreign law has to relate to an international matter. With regard to internationality, the determination as to whether there is an international element or not is to be made on a case-by-case basis. However, Swiss courts are rather reluctant to disregard the parties’ conscious election of foreign law if the case at hand has at least some international element.

(b) The application of provisions of foreign law is precluded if it would produce a result which is incompatible with Swiss public policy (ordre public). Pursuant to the jurisprudence of the Swiss Federal Supreme Court, an extremely unfair result is required to overrule Swiss public policy. However, the escape clause of the Swiss public policy applies only if there is a link to Switzerland in the particular case. The main areas of application of this clause are in the law of persons and in the family law.

(c) The election of foreign law is not recognised in case of mandatory provisions of Swiss law. For certain types of contracts, the PIL contains mandatory rules regarding the choice of the governing law. As to commercial relationships, the election of foreign law can be excluded or limited, in particular in the area of consumer protection, employment laws and product liability (see question 2.1 above).

Finally, the election of the governing law should not be made in bad faith.


Yes. Switzerland adopted the UN Convention on Contracts for the International Sale of Goods (CISG) of 11 April 1980 as per 1 March 1991. Pursuant to Art. 1 para. 1 CISG, the convention applies to contracts of sale of goods between parties whose places of business are in different states: (i) when the states are contracting states; or (ii) when the rules of private international law lead to the application of the law of a contracting state.

The CISG provides the substantive sales law for contracts regarding the international sale of goods, insofar as it contains provisions settling such matters. The rules of the convention supersede the national Swiss law. However, the convention itself does not regulate procedural matters and, consequently, the CISG does not provide for jurisdiction. The jurisdiction of the competent court is to be determined according to the rules of private international law of the forum state.

Since the requirements of the CISG (e.g. Art. 1 para. 1 lit. a) are met, the convention finds direct application without recourse to the Swiss rules on conflicts of laws. However, the parties may agree to exclude the application of the CISG, as it is often done in practice.
3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Switzerland’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Switzerland’s laws or foreign laws)?

No. The parties to a receivables purchase agreement are free to choose which law shall govern their contract, irrespective of the law governing the receivables themselves. However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL). In addition, the assignment of the receivables, however, is typically governed by the law governing the receivables themselves.

3.2 Example 1: If (a) the seller and the obligor are located in Switzerland, (b) the receivable is governed by the law of Switzerland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the obligor choose the law of Switzerland to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Switzerland, will a court in Switzerland recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Yes. Under Swiss conflict of law provisions, the parties to a receivables contract are free to choose which law shall govern their contract, irrespective of the law governing the receivables themselves. This applies whether the purchaser, the seller or the obligor are in different countries or not and whether the parties choose a jurisdiction in which one of them is located or not. In particular, a court in Switzerland permits the seller, the purchaser and the obligor to choose the law of Switzerland to govern the receivables sale if only one of the seller, the purchaser or the obligor is resident in Switzerland.

A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL). In addition, the assignment of the receivables, however, is typically governed by the law governing the receivables themselves.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Switzerland, will a court in Switzerland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

3.4 Example 3: If (a) the seller is located in Switzerland but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Switzerland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Switzerland’s own sale requirements?

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL).

3.5 Example 4: If (a) the obligor is located in Switzerland but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Switzerland recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Switzerland’s own sale requirements?

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL).

3.6 Example 5: If (a) the seller is located in Switzerland (irrespective of the obligor’s location), (b) the receivable is governed by the law of Switzerland, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in Switzerland recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in Switzerland and any third party creditor or insolvency administrator of any such obligor)?

Yes. Please refer to question 3.2. A court in Switzerland will recognise such a sale as being effective against the seller, the
obligor and other third parties, provided no mandatory provisions of law other than those chosen by the parties would be violated.

However, certain specifics regarding performance (e.g. transfer and perfection) of the receivables will be subject to the law of the state in which they actually occur, irrespective of the law governing the receivables contract (Art. 125 PIL).

In addition, the assignment of the receivables, however, is typically governed by the law governing the receivables themselves.

4 Asset Sales

4.1 Sale Methods Generally. In Switzerland what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The seller:

(i) enters into a purchase contract (which does not necessarily have to be in writing) with the purchaser; and

(ii) assigns the receivables against the respective obligor(s) to the purchaser.

In order for an assignment to be effective, the claims must be assignable, i.e. the assignment must not be prohibited by law, contractual non-assignment clauses or the nature of the receivables. The declaration of assignment must be made in writing and signed by at least the assignor. It is common practice that the parties enter into an assignment agreement signed by both parties. Notification to the respective obligor is not required in order for the assignment to be valid. However, until the obligor is notified of the assignment, the bona fide obligor may validly discharge his obligations by making payments to the assignor.

The customary terminology is a sale and assignment of receivables.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

The existence of a purchase agreement and an assignment in writing is required for an effective sale and assignment of receivables. Perfection does not require that the obligor be notified of the assignment. However, as long as the obligor is not notified of the assignment, he may validly discharge his obligations if he makes payments to the assignor in good faith.

A good faith purchaser/assignee of receivables does not exist (exceptions apply for bills of exchange/securities). If the assignor assigns the same receivables several times to different parties, the first assignee acquires first rights. After the first valid assignment, the assignor loses his right to dispose of said receivables and cannot validly assign them to any other party. The first assignee becomes the owner of the receivables. However, the obligor is protected if he has been notified of the second assignment only and makes payment to the alleged (later) assignee. The first and rightful assignee is then entitled to raise a claim for unjust enrichment and damages against the second assignee.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

The perfection of promissory notes (einfacher Schuldschein) relating to receivables requires a valid assignment.

With regard to mortgage-backed loans, the sale and transfer of receivables secured by a mortgage (Grundpfandverschreibung) as a right in rem over the underlying encumbered land to the purchaser will be effected by way of assignment. Such assignment is effective and perfected without notice to the respective obligors or filings with the competent land registry and will include the security over the encumbered land (which passes to the purchaser ex lege as ancillary right of the assigned receivables). Although no filings or registrations with the land registry are necessary for the perfection of the sale and transfer of receivables, purchasers will typically wish to be registered as creditors in the creditors’ register with the effect that insurers may not validly discharge their payment obligations to the land owner without the consent of the registered creditor.

In case a mortgage certificate (Schuldbrief) was provided as security by the obligor to the lender and (i) transferred to the latter by way of security (Sicherungsübereignung), the lender/originator selling the receivables (loan claims) to the special purpose vehicle (SPV) may transfer the security to the SPV by transferring the mortgage certificate to the SPV by way of security (Sicherungübereignung) or pledge (Pfand). In the case of bearer mortgage certificates, physical delivery is required and, in the case of registered mortgage certificates, physical delivery and endorsement are necessary. If instead, (ii) the mortgage certificate was pledged to the lender, the security passes to the SPV ex lege as ancillary right at the time of assignment of the loan claim.

The transfer of marketable debt securities requires, in case of bearer securities (Inhaberpapiere), physical delivery of the securities and in case of registered securities (Ordrepapiere), physical delivery and endorsement to the purchaser. Special rules apply for book-entry securities.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

A notification of the obligor is not required for the sale/assignment to be effective. No other formalities or filings with any administrative or governmental authority in Switzerland are required in order to render the sale/assignment of receivables effective. While the validity and effectiveness of the sale/assignment is not dependent on the notification to the obligor, the latter may validly discharge its obligations by payment to the seller/assignor, as long as the assignment has not been notified to the obligor.

In order to validly effect a sale/assignment of receivables, the obligor’s consent to the sale/assignment is not required, subject to the following exceptions, the contract between the seller/assignor
4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There is no requirement as to the form of the notice. One should, however, ensure that the obligor received the notice by sending the notice through adequate means (registered letter, courier, etc.). There is no limit beyond which notice is ineffective for Swiss law governed receivables against obligors domiciled in Switzerland. The notice applies to all (including future) receivables. For the effects of bankruptcy proceedings on future receivables, please refer to questions 6.1 to 6.5.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Switzerland? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Switzerland recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

A contract containing a prohibition to assign receivables is enforceable in Switzerland. There is one exception to this rule – which is, however, of little practical relevance: the obligor cannot raise against the in Switzerland. There is one exception to this rule – which is, however, of little practical relevance: the obligor cannot raise against the

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Under generally applicable principles of the Code of Obligations, the receivables must be identified or identifiable. Whether receivables are identifiable or not must be determined on a case-by-case basis. There are no standardised objective characteristics. With regard to future receivables (receivables which come into existence after the assignment), the Federal Supreme Court held that they must be identified or identifiable regarding the obligor, legal ground and amount. This, in particular, holds true in case the seller sells all of his receivables to the purchaser, including future receivables (Globalsession). It is, however, advisable to identify the receivables to be sold either in advance, or with respect to future receivables, periodically to evidence the receivables that have come into existence. Likewise, one could question as to whether it is sufficient identification of receivables if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The “true sale” principle aims to ensure that the sale of assets from the seller to the purchaser is made on a “no recourse” basis both from a legal and accounting perspective. The Swiss legal framework is able to satisfy all requirements which result from this concept although it is not a recognised legal concept under Swiss law (but is an accounting and tax concept). The question as to whether or not the “true sale” requirement is met or not will widely depend on the economic conditions and circumstances of each individual case. The fact that the seller retains a credit risk, or an interest rate risk, or the control of the collection of the receivables is as such not a factor which may jeopardise perfection. The factor which may put a true sale at risk would be circumstances where the price is not determined at arm’s length so that there is a risk of challenge by third party creditors requesting a “revocation” in the event of insolvency of the seller on the grounds that they have been defrauded by the sale of the receivables. The risk of such a claim is generally considered to be excluded if the sale of the receivables is made at market value.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Swiss law provides for the assignment of claims on a revolving basis (as and when they arise). The question as to whether or not receivables that come into existence after the date of the seller’s
bankruptcy can be validly assigned to the assignee, is not settled under Swiss law (please refer to question 4.10).

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

It is possible under Swiss law to sell/assign future claims (i.e. claims that come into existence after the date of the receivables purchase/assignment agreement) provided that they are sufficiently identified or identifiable as to the obligor, legal ground and amount (also see question 4.7). There is no further requirement for the sale and the assignment of future receivables to be valid and enforceable under Swiss law. There is no specific Federal Supreme Court decision regarding the enforceability of future receivables that have arisen (rather than matured only) after the commencement of Swiss bankruptcy proceedings with regard to the seller/assignor.

Since the assignor loses his capacity to dispose of the assigned claims upon the adjudication of bankruptcy/insolvency proceedings, receivables that arise after the seller's insolvency may not be validly assigned and the competent insolvency official may challenge the validity of the transfer of future claims.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The assignment of receivables includes so-called ancillary rights. Some security interests constitute such ancillary rights, e.g. a pledge. Hence, when receivables that are secured by a pledge are transferred, the pledge – automatically – passes to the assignee ex lege. However, other security interests such as mortgage certificates (Schuldbriefe) do not constitute ancillary rights and do not pass ex lege. Hence, when the receivables secured by a mortgage certificate are assigned to the purchaser/assignee, specific action is required in order for the security interest to pass to the assignee. Bearer mortgage certificates must be transferred by physical delivery and registered mortgage certificates by physical delivery and endorsement. Please also refer to question 4.3.

5 Security Issues

5.1 Back-up Security. Is it customary in Switzerland to take a "back-up" security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

It is not customary to provide for a ‘back-up’ security interest. However, the parties are at liberty to choose a back-up security.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Switzerland, and for such security interest to be perfected?

Security interest in receivables may be established by:
(i) assignment by way of security (Sicherungszession); or
(ii) pledge (Verpfändung).

Assignment by way of security is the more commonly used form to create security and is preferable for the assignee. In particular, it leaves more flexibility in terms of available foreclosure proceedings (when the purchaser/assignor becomes bankrupt) and will de facto lead to the earlier completion of foreclosure proceedings. The two forms of security are briefly described below.

Assignment by way of security (Art. 164 CO): when receivables are assigned, the assignee becomes the owner of the receivables. Even if, technically, the assignee could dispose of the assigned receivables freely due to his full ownership interest in the receivables, his right to dispose of the receivables is contractually limited; he is only allowed to dispose of the receivables in accordance with the underlying security assignment agreement and to realise the security for the secured obligations.

Pledge (Art. 899 et seqq. Civil Code (CC)): claims and other rights can be pledged if they are assignable. Claims are assignable unless the assignment is prohibited by law, contractual non-assignment stipulations or due to the nature of the receivables. The only formal requirement is that the pledge agreement be in writing. Neither the validity nor the perfection of the pledge depend on the notification of the debtor.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Switzerland to grant and perfect a security interest in purchased receivables governed by the laws of Switzerland and the related security?

Please refer to question 5.2.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Switzerland, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Switzerland or must additional steps be taken in Switzerland?

Under the Swiss conflicts of laws rules, the purchaser/parties is/are free to choose the law under which the purchaser grants a security interest. If the security interest is validly perfected under the relevant foreign law, the security interest will generally be treated as valid and perfected under Swiss law. Pursuant to the Swiss conflicts of laws rules, the following special rules apply to the debtors or third parties, respectively, in relation to the assigned or pledged receivables:

Assigned receivables: the assignor and the assignee’s choice of a foreign law may not be asserted against, and will not be binding upon, the debtor without his consent if the law governing the receivables is different from the chosen law. In other words, the validity and perfection of the foreign law-governed assignment cannot be asserted against the debtor, unless the debtor consents to the foreign law, or the requirements for a valid and perfected assignment under the laws governing the receivables are met.
Pledged receivables: the pledgor and the pledgee’s choice of foreign law may not be asserted against, and will not be binding upon: (i) the debtor, if the law governing the receivables is different from the chosen law; and (ii) bona fide third parties, such as third party creditors.

Instead, the law governing the receivables will apply to the debtor (unless the debtor consents to the law chosen by the pledgor and pledgee) and the law of the jurisdiction where the pledgee is resident will apply to bona fide third parties.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

A security interest in marketable debt instruments can be created by way of pledge. The establishment of a pledge in respect of marketable debt securities requires physical delivery of the certificates (in the case of bearer instruments) together with an endorsement (in the case of instruments drawn to the order of a person) or assignment. A security interest can also be established by transfer by way of security (Sicherungsaufbewahrung). The same rules apply.

Under Swiss law, neither notification of the debtor (or owner of the encumbered land in case of mortgages) nor registration or filing with a governmental authority is required for the perfection of the pledge.

5.6 Trusts. Does Switzerland recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets until turned over to the purchaser?

Substantive Swiss trust law does not exist. Therefore, a trust in its literal sense cannot be set up under Swiss law. Since July 2007, the Hague Convention on the Law Applicable to Trusts and on their Recognition 1985 (Hague Trust Convention) is applicable in Switzerland. The conflict of laws rules have incorporated the Hague Trust Convention into national law and allows for full and complete recognition of foreign trusts in Switzerland.

Collections received by the seller in respect of sold receivables can be held in a separate account of the seller apart from his own assets until the collection proceeds are turned over to the purchaser. After the assignment of receivables, the assignee is the rightful owner of the receivable. Therefore, the assignee has to authorise the assignor to collect the receivables (in his own name) on behalf of the assignee. To ensure that the debtors transfer the funds to a separate account of the seller, the receivables contract between the seller and the debtors has to specify such separate account.

5.7 Bank Accounts. Does Switzerland recognise escrow accounts? Can security be taken over a bank account located in Switzerland? If so, what is the typical method? Would courts in Switzerland recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Switzerland?

Switzerland recognises escrow accounts. It is also possible to create a security interest over bank accounts located in Switzerland. There are two possibilities: bank account assets and claims against the bank relating to the bank account assets can either be: (i) pledged; or (ii) assigned by way of security. A pledge is preferable for the security provider/pledgor since he remains the owner of the bank account assets, whereas an assignment is preferable for the security taker/assignee because he becomes the owner of the bank account assets. He is also in a better position in foreclosure proceedings. For further reference, please see question 5.3.

Pursuant to the Swiss conflicts of laws rules, the parties are free to choose the law under which they create a security interest. If the security interest over a Swiss bank account is validly perfected under the relevant foreign law, the security interest will generally be treated as valid and perfected under Swiss law between the parties (security provider and security taker). However, limitations apply in relation to the account bank. The foreign law may not be binding for the account bank. Please refer to question 5.4.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Security over Bank Accounts is typically taken by way of assignment or by way of a pledge. The object of the assignment or the pledge is, amongst others, the right of the account holder against the account bank to deliver any accounts standing to the credit of the account holder. This means that the secured party controls any cash flowing into the bank account, provided there are no other first priority rights. In particular, the account bank, under its general terms and conditions, do has first priority rights. The secured party is further limited that in case of an assignment of the claims against the account bank (but not in case of a pledge), after the bankruptcy of the account holder, the future claims and cash fall into the bankruptcy estate and the secured party has no control rights over any future cash flowing in the bank account after such an bankruptcy event. Please also see question 6.1 below.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, this is possible. The security agreement provides as to whether the owner of the account has access to the funds in the account prior to enforcement.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Switzerland’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Swiss law distinguishes between the sale of existing receivables and the sale of future receivables: In general, existing receivables validly assigned are bankruptcy remote. This means, in the event of bankruptcy or similar insolvency proceedings against the seller, the existing receivables will not fall within its bankrupt estate. Moreover, the openings of bankruptcy or similar proceedings do not cause an “automatic stay” of such receivables under Swiss law. Accordingly, the purchaser is
free to collect, transfer or otherwise exercise his ownership rights over the assigned receivables.

Future receivables are defined as assigned receivables that have not yet come into existence. Such receivables may be assigned under Swiss law if the future claims can be defined with sufficient specificity, whereas the assignment becomes effective upon existence of the assigned receivable. However, a valid assignment of future receivables will cease to be valid if bankruptcy proceedings are opened against the originator of the receivables. The opening of bankruptcy proceedings causes all obligations to fall due, according to Art. 208 para. 1 Federal Statute on Debt Enforcement and Bankruptcy (Bankruptcy Act) of 11 April 1889. Pursuant to the current jurisprudence of the Swiss Federal Supreme Court, future receivables are not deemed to have been validly assigned and therefore fall within the bankruptcy estate of the seller in the event of bankruptcy or similar insolvency proceedings against the seller (Durchgangstheorie). Regarding the assigned future receivables, the purchaser will be treated as an unsecured creditor ranking equal to all the other unsecured creditors of the bankruptcy seller (mainly in the third class). Although no “automatic stay” applies under Swiss law with respect to future receivables, the purchaser is not entitled to collect, transfer or otherwise exercise ownership rights.

According to the prevailing opinion in Switzerland, the assignment of receivables is linked to the underlying transaction (e.g. the assignment agreement) and therefore only valuable if the sale is perfected. With the opening of bankruptcy proceedings, all seizable assets owned by the debtor at this time, irrespective of where they are situated, form part of the bankruptcy estate. This applies also to controversial receivables.

Immediately upon receipt of the bankruptcy order, the insolvency official raises an inventory of the assets belonging to the bankruptcy estate. If the insolvency official doubts the sale of certain (existing) receivables to be perfected, he lists the receivables in the inventory. Further, the insolvency official has the ability to take all necessary measures for their safeguarding (Art. 221 Bankruptcy Act), e.g. a stay collection and enforcement actions until it is determined that the sale is perfected.

According to Swiss law, it makes no difference whether or not the receivables have been assigned for security purposes (Sicherungszession) in connection with a secured financing.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Once bankruptcy proceedings have been opened, claims forming part of the bankruptcy estate can no longer be validly discharged by payment to the debtor (Art. 205 Bankruptcy Act). With regard to future receivables (which fall into the bankruptcy estate of the seller), the competent insolvency official will notify the debtors of the opening of bankruptcy proceedings and inform them that the sole legally valid way of discharging their obligation is by payment to the bankruptcy office. Payment made to the purchaser will not relieve the debtor from its payment obligations, unless it is otherwise received by the bankrupt estate. As to the already existing receivables, the competent insolvency official will not interfere with the exercise of rights, provided that the sale is effective and perfected (see question 6.1 above).

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in Switzerland for (a) transactions between unrelated parties and (b) transactions between related parties?

The insolvency official can avoid a transaction (action pauliana) under the following circumstances:

(a) Any relevant transaction which the debtor made during a suspect period of one year before the seizure of assets or the opening of bankruptcy proceedings is voidable. Relevant transactions are gifts and voluntary settlements, as well as transactions equivalent to a gift, e.g. transactions in which the debtor accepted a counter-performance out of proportion to his own or transactions through which the debtor obtained for himself or a third party a life annuity, an endowment, a usufruct or a right of habitation (Art. 286 Bankruptcy Act).

(b) The insolvency official may avoid the granting of collateral for existing obligations without the obligation to do so, the settlement of a debt of money by unusual means and the payment of an obligation not yet due for payment, provided that (i) the debtor carried them out during a suspect period of one year before the seizure of assets or the opening of bankruptcy proceedings, and (ii) the debtor was at that time already insolvent. The transaction is not avoided, however, if the recipient proves that he was unaware, and need not have been aware, of the debtor’s insolvency (Art. 287 Bankruptcy Act).

(c) Finally, all transactions which the debtor carried out during a suspect period of five years prior to the seizure of assets or the opening of bankruptcy proceedings with the intention, apparent to the other party, of disadvantaging his creditors or of favourising certain of his creditors to the disadvantage of others are voidable (Art. 288 Bankruptcy Act).

As to the length of the suspect period, Swiss law does not distinguish between transactions between related and unrelated parties.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

As long as the purchaser is legally independent from the seller and is acting in arm’s length terms, the risk of consolidation is quite remote from a Swiss law perspective. The legal concept of a “true sale” is not established in Switzerland (see question 3.4 above). Therefore, no distinction is made between “true sale” and secured financing under Swiss law. However, in a secured financing, the seller may reserve the right to repurchase the assigned receivables from the purchaser. In such case, the insolvency official may assume that there is no valid assignment of the receivables, which would lead to a de facto consolidation. However, such risks can be prevented by a proper wording and structure of the assignment agreement.
6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Switzerland, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Pursuant to the current jurisprudence of the Swiss Federal Supreme Court, the sale of future receivables by way of assignment is not bankruptcy remote (see question 6.1 above). After the opening of bankruptcy proceedings, such receivables fall within the bankruptcy estate of the seller on which the bankruptcy administration (Konkursverwaltung) has the exclusive power to dispose. The debtor himself is no longer allowed to dispose of the assets within the bankruptcy estate. Acts by the debtor concerning such assets deem to be invalid as against his creditors (Art. 204 para. 1 Bankruptcy Act).

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Switzerland establishing a legal framework for securitisation transactions? If so, what are the basics?

There is no special securitisation law in Switzerland. Regarding the transfer of assets from the originator to the SPV, the provisions of the Code of Obligations are applicable (in particular, the provisions regarding sale and assignment).

7.2 Securitisation Entities. Does Switzerland have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Switzerland does not have any such special laws for SPVs. Stock corporations and limited liability companies are available for the establishment of an SPV. The requirements for the establishment and management of an SPV, as well as the status of directors and shareholders, are set forth in the respective statutory provisions applicable to stock corporations and limited liability companies.

7.3 Non-Recourse Clause. Will a court in Switzerland give effect to a contractual provision (even if the contract's governing law is the law of another country) limiting the recourse of parties to available funds?

A court in Switzerland might not give effect to a contractual provision alone limiting the recourse of parties to available funds. The whole transaction as a whole must be structured in way that the no recourse is possible (please refer to question 4.8).

7.4 Non-Petition Clause. Will a court in Switzerland give effect to a contractual provision (even if the contract's governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

The principle of liberty of contracts governs Swiss law. The parties are thus at liberty to enter into an agreement waiving the right to take legal action against the SPV. Such non-petition clauses are enforceable, subject to the following limitations: a party may not validly waive its rights under compulsory provisions of Swiss law or in a way that would be against “bonos mores” (Art. 27 CC). Further, such a waiver may be subject to challenge in the case of bankruptcy of one of the parties who has waived his rights against the SPV, in accordance with the limitations which result generally from Swiss bankruptcy law.

7.5 Priority of Payments "Waterfall". Will a court in Switzerland give effect to a contractual provision (even if the contract's governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

It is possible to contractually agree on a certain order. There is no reason why a court should not uphold such provision, whether agreed under Swiss law or any other (applicable) law, unless such order would clearly be against public policy. In case of a bankruptcy, however, the creditors will be grouped in three main classes depending on the type of creditor, and the bankruptcy administrator will not consider such contractually agreed provisions (unless the subordination is made with respect to all other creditors). However, in the internal relationship between the parties, a contractual provision relating to a certain order is enforceable (in court) between the parties in question.

7.6 Independent Director. Will a court in Switzerland give effect to a contractual provision (even if the contract's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

As a principle, there is no such contractual subordination that a court must give effect to, apart from in case of a specific subordination where a creditor subordinates its claims against the claims of all other creditors.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Switzerland, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Switzerland? Does the answer to the preceding question change if the purchaser does business with other sellers in Switzerland?

The mere purchasing, ownership or collecting of receivables will neither require a foreign purchaser to do business or obtain any licence in Switzerland nor is such a purchaser qualified as a financial institution (e.g. securities dealer, financial intermediary, investment fund, bank, insurer) under Swiss law. This analysis changes only if the purchaser conducts a business in Switzerland that requires a licence. The mere fact that the purchaser does business with other sellers in Switzerland does not change this analysis.
8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The mere purchasing, enforcing or collecting of the sold receivables by the seller (servicing) does not require the seller to obtain any licence in Switzerland. The same applies to a third party replacement servicer.

8.3 Data Protection. Does Switzerland have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

In Switzerland, the processing of information is mainly regulated in the Federal Act on Data Protection (Data Protection Act) of 19 June 1992. The Data Protection Act applies to the processing of data pertaining to natural persons and corporations by private persons and federal bodies. However, it does not apply to personal data that is processed by a natural person exclusively for personal use and which is not disclosed to outsiders. Data that doesn’t qualify as ‘sensitive personal data’ or ‘personality profiles’ under the Swiss Data Protection Act can be communicated without the consent of the debtor (Art. 4 para. 5 e contrario Data Protection Act).

The Data Protection Act contains a special regulation relating to cross-border disclosure. Thus, personal data may not be disclosed abroad if the privacy of the data subjects would be seriously endangered thereby, in particular due to the absence of legislation that guarantees adequate protection. In the absence of such legislation, disclosure of personal data abroad is subject to various restrictions, including the following: (i) sufficient safeguards (in particular contractual clauses) shall ensure an adequate level of protection abroad; (ii) the data subject must have consented in the specific case; and (iii) the processing shall be directly connected with the conclusion or the performance of a contract and the personal data shall be that of a contractual party (Art. 6 Data Protection Act).

The use or dissemination of data by Swiss banks requires special precautions due to the Swiss banking secrecy. Swiss banking secrecy is based on the contractual relationship between the bank and its clients, e.g. the bank’s loyalty as an agent to the client as principal, the bank’s obligation not to contravene the client’s privacy rights and Art. 47 of the Swiss Federal Act on Banks and Savings Institutions (Banking Act) of 8 November 1934 which makes the violation of banking secrecy a criminal offence.

Swiss banking secrecy imposes an obligation upon the bank, their executive bodies and their employees to treat any client-related information confidentially so as to avoid any disclosure of information potentially harmful to a client’s interest. However, client’s right to privacy does not mean, that Swiss banks do not need to know the identity of their clients. Moreover, Swiss banks are obligated to identify each of their contractual partners and specifically the beneficial owner of the assets involved in any business relationship. Thus, it has to be noted that there are no ‘anonymous accounts’ in Switzerland as regards the bank’s duty to identify their clients. This banking secrecy has never been absolute, and the obligation to secure their client’s privacy does not dispense banks from federal and cantonal disclosure obligations. In particular, legal assistance is granted in the event of tax fraud. The Data Protection Act and the bank secrecy rules apply both to individuals and enterprises.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Switzerland? Briefly, what is required?

The Federal Act on Consumer Credit of 23 March 2001 (Consumer Credit Act) applies only to certain agreements between lenders and consumers, such as loans not secured by mortgages or usual guarantees, loans for amounts between CHF 500 and CHF 80,000 or short-term loans (Art. 7 para. 1 lit. e e contrario Consumer Credit Act).

Agreements under the Consumer Credit Act must be concluded in writing. It has to be noted that the Consumer Credit Act basically allows the consumer to terminate his loan at any time by repaying the outstanding amount. Such an early termination allows the consumer to retrieve a part of the costs of his loan (Art. 17 para. 2 Consumer Credit Act).

8.5 Currency Restrictions. Does Switzerland have laws restricting the exchange of Switzerland’s currency for other currencies or the making of payments in Switzerland’s currency to persons outside the country?

The Federal Act on Consumer Credit of 23 March 2001 (Consumer Credit Act) applies only to certain agreements between lenders and consumers, such as loans not secured by mortgages or usual guarantees, loans for amounts between CHF 500 and CHF 80,000 or short-term loans (Art. 7 para. 1 lit. e e contrario Consumer Credit Act).

Agreements under the Consumer Credit Act must be concluded in writing. It has to be noted that the Consumer Credit Act basically allows the consumer to terminate his loan at any time by repaying the outstanding amount. Such an early termination allows the consumer to retrieve a part of the costs of his loan (Art. 17 para. 2 Consumer Credit Act).

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Switzerland? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments by a Swiss debtor are, in general, not subject to Swiss withholding tax. However, interest payments may be subject to Swiss withholding tax at a rate of 35 per cent if made under a banking account, bond, debenture or money market paper, or if a Swiss debtor’s overall financing activities are regarded, for tax purposes, as so-called “collective fund raising”. In addition, interest payments made to non-Swiss lenders are subject to a withholding tax at source if the debt is secured by mortgages in Swiss real estate.

9.2 Seller Tax Accounting. Does Switzerland require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No. Under Swiss law, there is to date no specific accounting policy which must be adopted for tax purposes by the seller or purchaser in the context of a securitisation transaction.
### 9.3 Stamp Duty, etc. Does Switzerland impose stamp duty or other documentary taxes on sales of receivables?

No stamp duty is payable on sales of receivables unless such receivables are regarded as bonds, debentures or money market papers and are transferred by or via a securities dealer under Swiss stamp tax law. The statutory stamp duty rate amounts to 0.15 per cent on the transfer of Swiss bonds, debentures or money market papers, and to 0.3 per cent on bonds, debentures or money market papers issued by a non-Swiss person.

### 9.4 Value Added Taxes. Does Switzerland impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The sale of goods and the provision of services, including those of a collecting agent (“servicing”), are, in general, subject to Swiss value added tax (VAT) at the current standard rate of 8.0 per cent. The sale of receivables is exempt from VAT as a financial transaction but the purchaser may become liable for the VAT included in the assigned receivables.

### 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

In general, the taxing authority will not be able to make such claims regarding VAT, stamp duty or income and profit taxes. However, Switzerland has introduced a completely revised VAT Act as from 1 January 2010. The new Act includes under certain conditions a secondary liability of the purchaser with respect to VAT included in receivables sold/assigned and remaining unpaid in the insolvency of the seller.

### 9.6 Doing Business. Assuming that the purchaser conducts no other business in Switzerland, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Switzerland?

The mere purchase of receivables, appointment of the seller as its servicer or collecting agent, or the enforcement of receivables against the debtors does not make the purchaser subject to Swiss income tax under Swiss national income tax laws.
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Chapter 38

Taiwan

Lee and Li, Attorneys-at-Law

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Generally, it is unnecessary for the sales of goods or services to be evidenced by a formal receivables contract. An agreement between the parties to the transaction, either orally or in writing, would suffice, unless the law requires otherwise. For instance, an agreement in writing is required for an instalment sale between enterprises and the consumer according to the Consumer Protection Act. Whether invoices of the sale of goods or services alone are sufficient to prove the sale will be determined by a court on a case-by-case basis. If invoices contain the elements necessary for the constitution of a contract, normally the court would accept invoices alone as being sufficient. A contract may be presumed to exist based on evidence including, but not limited to, the behaviour of the parties, communications between the parties and customary practices.

1.2 Consumer Protections. Do Taiwanese laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

The Civil Law provides that if the agreed rate of interest exceeds twenty per cent (20%) per annum, the creditor shall not be entitled to claim any interest over twenty per cent (20%) per annum. In the case of a debt bearing interest, if no rate has been agreed under the contract or by law, the rate shall be five per cent (5%) per annum (“Statutory Interest Rate”). With respect to late payments, a creditor is entitled to charge interest on late payments calculated at the agreed rate or Statutory Interest Rate, whichever is higher. Generally, consumers may not cancel receivables for a specified period of time unless specifically permitted by law. For instance, the Consumer Protection Act entitles consumers of a mail order sale or door-to-door sale to cancel the transaction without cause within seven days from receipt of the goods/services.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Essentially, the same requirements and laws apply to the sale or collection of receivables where the receivables contract has been entered into with the government or a government agency.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Taiwan that will determine the governing law of the contract?

Assuming that no “foreign element” is involved (i.e., all parties to the contract are Taiwanese entities/persons; the conclusion and performance of the contract are within Taiwan; and the subject matter of contract is within Taiwan), the court would generally use Taiwanese law as the governing law.

By contrast, if a foreign element is involved, the Law Governing the Application of Laws to Civil Matters Involving Foreign Elements (“Application of Laws”) provides that the law of the jurisdiction having the closest relevance with the contract will govern the contract. However, the relevant provisions of the foreign law would not be applied to the extent the courts of Taiwan hold that (i) the application of such provisions would be contrary to the public order or good morals of Taiwan, or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law.

2.2 Base Case. If the seller and the obligor are both resident in Taiwan, and the transactions giving rise to the receivables and the payment of the receivables take place in Taiwan, and the seller and the obligor choose the law of Taiwan to govern the receivables contract, is there any reason why a court in Taiwan would not give effect to their choice of law?

In this situation, it is very unlikely that a Taiwanese court would not give effect to the parties’ choice of law.
2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Taiwan but the obligor is not, or if the obligor is resident in Taiwan but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Taiwan give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Generally, the choice of a foreign law to govern a receivable contract would be recognised as a valid choice of law and given effect by the courts of Taiwan; provided that the relevant provisions of the foreign law would not be applied to the extent such courts hold that (i) the application of such provisions would be contrary to the public order or good morals of Taiwan, or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwanese law.


3 Choice of Law – Receivables Purchase Agreement

3.1 Base Case. Does Taiwanese law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Taiwanese laws or foreign laws)?

The Application of Laws provides that the effect on the assignment of the receivables against the obligor shall be governed by the law governing the receivables. For instance, under Taiwanese law, if the contract is governed by Taiwanese law, a notice should be served with the obligor in order for the assignment to take effect against the obligor. Therefore, the seller or the purchaser should give a notice to the obligor upon the assignment of the receivables in order for the assignment to take effect against the obligor.

3.2 Example 1: If (a) the seller and the obligor are located in Taiwan, (b) the receivable is governed by the law of Taiwan, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Taiwan to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Taiwan, will a court in Taiwan recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Generally, a Taiwanese court would recognise that sale as being effective against the seller and other third parties, and upon notification to the obligor, the obligor. However, since the seller is located in Taiwan, the sale of receivables by the seller remains subject to any bankruptcy, insolvency, reorganisation or other similar laws affecting the rights of creditors generally.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Taiwan, will a court in Taiwan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Generally, a Taiwan court would recognise that sale as being effective against the seller and other third parties. However, since the seller is located in Taiwan, the sale of receivables by the seller remains subject to any bankruptcy, insolvency, reorganisation or other similar laws affecting the rights of creditors generally.

3.4 Example 3: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Taiwan, will a court in Taiwan recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with Taiwanese own sale requirements?

Assuming that both the contract of receivables and the sale and purchase are legal, valid and binding under the law of the obligor’s country, generally, a Taiwanese court would recognise that sale as being effective against the seller and other third parties based on the law of the obligor’s country. However, since the seller is located in Taiwan, the sale of receivables by the seller remains subject to any bankruptcy, insolvency, reorganisation or other similar laws affecting the rights of creditors generally. In addition, the relevant provisions of the foreign law governing the sale of receivables would not be applied to the extent the courts of Taiwan hold that (i) the application of such provisions would be contrary to the public order or good morals of Taiwan, or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwanese law.

3.5 Example 4: If (a) the obligor is located in Taiwan but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in Taiwan recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with Taiwanese own sale requirements?

Assuming that both the contract of receivables and the sale and purchase are legal, valid and binding under the law of seller’s country, generally, a Taiwan court would recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) based on the law of the seller’s country. In addition, the relevant provisions of the foreign law governing the sale of receivables would not be applied to the extent the courts of Taiwan hold that (i) the application of such provisions would be contrary to the public order or good morals of Taiwan, or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwan law.
Since the receivable is governed by Taiwanese law, whether the sale is effective against the obligor and third party creditors or insolvency administrator of the obligor should be governed by Taiwanese law. Generally, the Taiwanese court will recognise the sale as being effective against the obligor and third party creditors or insolvency administrator of the obligor if the obligor is served with a notice of the assignment of the receivables to the purchaser.

In addition, because the receivables purchase agreement is governed by the law of the purchaser’s country, whether the sale is effective against the seller and third party creditors or insolvency administrator of the seller should be governed by the law of the purchaser’s country. Generally, the Taiwanese court will recognise the sale as being effective against the seller and third party creditors or insolvency administrator of the seller based on the law of the purchaser’s country if such sale complies with the law of the purchaser’s country. However, since the seller is located in Taiwan, the sale of receivables by the seller remains subject to any bankruptcy, insolvency, reorganisation or other similar laws affecting the rights of creditors generally. In addition, the relevant provisions of the foreign law governing the sale of receivables would not be applied to the extent the courts of Taiwan hold that (i) the application of such provisions would be contrary to the public order or good morals of Taiwan, or (ii) such provisions would have the effect of circumventing mandatory and/or prohibitive provisions of Taiwanese law.

### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

No particular formalities are required for perfecting a sale of receivables except for a notice to the obligor of such transfer.

### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

#### 1. Promissory Notes

Under Taiwanese law, transfer of promissory notes issued by the obligor requires: (i) endorsement made by the seller on the promissory notes to the purchaser; and (ii) delivery of the promissory notes to the purchaser. However, if the promissory note is prohibited by the note issuer (such as the obligor) from transfer by way of the endorsement, the promissory note cannot be transferred to the purchaser.

#### 2. Mortgage Loans

The transfer of the mortgage loan from the seller to the purchaser requires a notice to the obligor.

There are two types of mortgages: a general mortgage; and a mortgage with a maximum secured amount. A general mortgage is to secure a specific debt owed by the debtor to the creditor, while a mortgage with a maximum secured amount is to secure a variety of debts owed by the debtor to the creditor up to a specified maximum amount. In case of a general mortgage, the mortgage securing the loan generally will be transferred simultaneously to the person (e.g., the purchaser) to whom the secured loan is transferred, while the aforesaid person can foreclose the mortgage only upon duly registering itself as the mortgagee with local authorities.

In case of a mortgage with a maximum secured amount, before the underlying debts are crystallised and confirmed, the mortgage will not tag along with the transfer of the loan. After the underlying debts are crystallised and confirmed, the mortgage securing the loan will be transferred simultaneously to the person to whom the secured loan is transferred.

#### 3. Consumer Loans

The perfection of transferring consumer loans is generally the same as that of receivables. There are no additional or different requirements for sale and perfection of consumer loans. Nevertheless, when the seller is a financial institution in Taiwan, the sale by the financial institution of the consumer loans to the purchaser are subject to regulations primarily promulgated by the Banking Bureau, Financial Supervisory Commission, the regulator of financial institutions in Taiwan.

#### 4. Marketable Debt Securities

Sale and perfection of marketable debt securities is subject to different requirements depending on the types of securities. For example, corporate bonds may be issued in bearer form or registered form. For registered corporate bonds, sale and perfection of such bonds between the seller and the purchaser requires endorsement made by the bond holder on the bond certificate to the purchaser and delivery of the bond certificate to the purchaser. Further, in order for the transfer to take effect against the issuing company, the name and residence of the transferee should be recorded in the counterfoil of the corporate bonds. By contrast, if the corporate bonds are in bearer form, delivery of the corporate...
bonds would suffice. Where the corporate bonds are registered and deposited with the securities depository and clearing institution in Taiwan (i.e., Taiwan Depositary & Clearing Corporation, “TDCC”) or in global form or in scripless form, the sale and perfection of the corporate bonds should be made by way of book-entry.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Under the Civil Law, if the receivable contract is silent on the transferability of receivables, the seller may transfer the receivables against the obligor to the purchaser. Notice is required in order for the sale of the receivables to be effective against the obligor. If the receivable contract prohibits such transfer, the receivable cannot be transferred unless obtaining the obligor’s consent to the sale of receivables.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There is no special requirement on the form of notice or how it must be delivered. In addition, there is no time limit beyond which notice is ineffective, and therefore notice of a sale may be delivered to the obligor even after insolvency proceedings against the obligor have commenced. A notice of sale can also be delivered to the obligor even after insolvency proceedings against the seller have commenced, provided that (i) the sale of receivables occurs prior to commencement of insolvency proceedings against the seller, and (ii) the bankruptcy administrator does not rescind the sale as mentioned in our response to question 6.1. However, in each of the above two cases, the sale will take effect against the obligor only when the obligor is notified. Further, according to precedents of Taiwanese courts, in order for the sale of future receivables to be effective against the obligor, the notice for transfer of future receivables should be delivered to the obligor again when such future receivables come into existence.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Taiwan? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Taiwan recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions in receivables contracts prohibiting sale or assignment are generally enforceable in Taiwan. For contracts between commercial entities, we are not aware of exceptions to this rule. If the seller sells receivables to the purchaser without regard to the prohibitions in the contracts, the seller will be liable to the obligor for breach of contract and the obligor may claim damages caused thereby against the seller and argue that the sale cannot take effect against the obligor.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

It is not necessary to specifically identify each of the receivables to be sold in the sale document in order to perfect the sale of receivables so long as such receivables are reasonably identifiable (e.g., names of obligors or the date of receivables contract). The receivables being sold need not share objective characteristics. Nonetheless, if the seller only states that (i) all of its receivables are sold to the purchaser, or (ii) all of its receivables other than receivables owing by one or more specifically identified obligors are sold to the purchaser, in either case, it may not be sufficient to identify receivables.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The parties’ intent is one of the aspects that the court will take into account when determining whether the transaction at issue is a sale or, for instance, a loan. In addition to the parties’ intent, it is possible that the court looks into the economic effects of the transaction to determine its nature. From the perspective of Taiwanese law, a sale is defined as occurring when a seller agrees to sell chattel, property or right (such as a claim against the obligor) to a purchaser and the purchaser agrees to pay the consideration for such chattel, property or right. In order for the seller to transfer the claim against the obligor, a notice to the obligor is required. For instance, if the seller keeps the title to the claim against the obligor without transferring the same to the purchaser and giving a notice...
to the obligor, it is possible that the court may consider it as a credit transaction other than a sale.

Subject to the court test, so long as the title to the receivables is transferred to the purchaser, the purchaser pays a fair consideration and the obligor has been duly notified, the transfer of the receivables would be considered as a sale under the Civil Law.

As for the interest rate risk, generally, interest payment is not a legal feature of a sale except for the circumstances where, for example, late payment of the purchase price or delay of delivering the goods is involved. If the sale contains arrangement regarding interest rate risk, the court may challenge the nature of the transaction.

Concerning control of collection of receivables, it is not determinative of a sale. For instance, even if the seller sells and transfers the receivables to the purchaser, the purchaser may delegate the seller for collecting the receivables.

In addition, subject to the court test, so long as the title to the receivables is transferred to the purchaser, the purchaser pays a fair consideration and the obligor has been duly notified, the transfer of the receivables would be considered as a sale under the Civil Law without being affected by the feature of a right of repurchase/redemption.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes. However, as mentioned in our response to question 4.7, the receivables should be reasonably identifiable. In addition, if future receivables are involved, a notice for transfer of future receivables should be delivered to the obligor again when such future receivables come into existence.

4.10 Future Receivables. Can the seller commit in an enforceable manner (at least prior to its insolvency) to future receivables (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Taiwanese courts once held that the seller may sell to the purchaser the receivables that come into existence after the date of the receivables purchase agreement so long as such receivables are identifiable. In addition, if future receivables are involved, a notice for the transfer of future receivables should be delivered to the obligor again when such future receivables come into existence. However, once the bankruptcy status of the seller is declared, the sale of future receivables may be challenged by the insolvency officials because under the Bankruptcy Law, the receivables arising after the seller’s insolvency will be considered as part of bankruptcy estate and the seller has no capacity to dispose of the bankruptcy estate.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Under the Civil Law, as a general principle, the security interest will be transferred concurrently with the transfer of secured receivables with a few exceptions, such as the mortgage with a maximum secured amount as mentioned in our response to question 4.3. However, in order for the purchaser to foreclose the security, certain formalities are required to be completed based on different types of security interest involved. For instance, where the security interest is mortgage, the purchaser shall register itself with the local authorities as the new mortgagee in order to foreclose the mortgage. To give another example, if the security interest is a pledge over personal property, the possession of the pledged personal property shall be delivered to the purchaser in order for the purchaser to foreclose the personal property.

5 Security Issues

5.1 Back-up Security. Is it customary in Taiwan to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

To our knowledge, it is not customary in Taiwan for the purchaser to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected. However, as promissory notes are deemed as an instrument upon which the noteholder may rely to take an enforcement action against the issuer without going through the lengthy legal proceeding to obtain a judgment, in some cases the bank as the purchaser will require the seller to issue a promissory note which entitles the purchaser to exercise the rights of the promissory note against the seller for fear that the transfer of the receivables is not effective or revoked and the seller fails to reimburse the purchaser.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Taiwan, and for such security interest to be perfected?

Please refer to our response to question 5.1.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Taiwan to grant and perfect a security interest in purchased receivables governed by the laws of Taiwan and the related security?

In Taiwan, a security interest in a receivable is generally granted in the form of a pledge of rights. Under the Civil Law, in order to effectively pledge receivables, execution of a pledge agreement is required. In addition, in order for the pledge of the receivables to take effect against the obligor, a notice to the obligor is required. Furthermore, the pledgor should deliver the instruments (such as receivable contracts) evidencing the receivables to pledgee; however, this is merely an obligation of the pledgor but not a requirement on the perfection of the pledge. The pledge of receivables is not required to be registered with local government authorities.
5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Taiwan, and that security interest is valid and perfected under the laws of the purchaser's country, will it be treated as valid and perfected in Taiwan or must additional steps be taken in Taiwan?

According to the Application of Laws, the governing law of the pledge of rights shall be determined based on the law governing the creation of rights. Since the receivable is governed by Taiwanese law, the creation and perfection of the pledge over the receivable should be governed by Taiwan law as well. If the pledgor and the pledgee choose a law other than Taiwan law as the governing law of the pledge, the creation and perfection of the pledge should still comply with Taiwanese law, i.e., execution of a pledge agreement and notice to the obligor. In the event that the creation and perfection of the pledge is governed by a foreign law and inconsistent with the Taiwanese law, such pledge would not be recognised by the Taiwanese court.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

1. Insurance Policies

Generally, the requirements on the pledge of receivable apply to pledges by the insured of its rights against the insurance company under the insurance policy. However, according to the Insurance Law, if the proposer enters into a life insurance with the insurance company and the proposer is not the insured, the pledge of the rights in the insurance policy is subject to a written consent from the insured.

2. Promissory Notes

The Law of Negotiable Instruments does not explicitly provide the method to create a pledge over promissory notes and it is not common to create a pledge over a promissory note in Taiwan. Nonetheless, most of the scholars argue that the note holders may pledge the promissory note by following the general provisions in connection with a pledge over securities under the Civil Law. In other words, (i) endorsement (including a notation as to the purpose for which the pledge is created) made by the grantor on the promissory notes (not applicable in the case where the payee is not named), and (ii) delivery of the same to the grantee are required to perfect the creation of pledge over the promissory notes.

3. Mortgage Loans

Essentially, the requirements on a pledge of receivables apply to a pledge of mortgage loans.

4. Consumer Loans

Essentially, the requirements on a pledge of receivables apply to a pledge of consumer loans.

5. Marketable Debt Securities

As to creating a pledge over marketable debt securities, in general, the method to perfect pledge over debt securities is identical to that applied to securities as stated in section 2, above “Promissory Notes” (i.e., (i) endorsement made by the pledgor on the debt securities, and (ii) delivery of the same to the pledgee) unless otherwise provided by laws or regulations. In addition, for debt securities registered with the TDCC without physical certificates, creation of a pledge over such securities should be made through the TDCC and with relevant documents submitted as required by the TDCC.

5.6 Trusts. Does Taiwan recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes. Trusts are recognised under Taiwanese law.

5.7 Bank Accounts. Does Taiwan recognise escrow accounts? Can security be taken over a bank account located in Taiwan? If so, what is the typical method? Would courts in Taiwan recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Taiwan?

Escrow arrangements may take several forms depending on the agreement between the parties concerned. While there is no legal concept of “escrow account” under Taiwan law, Taiwan recognises pledges over a bank account. Under Taiwanese law, a pledge over a bank account requires a written agreement between the pledgor and the pledgee and a notice to the bank. However, there is no such concept of a floating charge under Taiwanese law. In practice, in the case of a pledge over a current account, the pledgor normally would deliver, on a monthly basis, the statement of credit balance of its bank accounts on which a pledge is created to the pledgee, and the accounts receivable represented by the number shown in the aforesaid statement would be the subject receivables of pledge. Taiwan court’s recognition of a foreign-law grant of security taken over a bank account (for instance, pledge over the bank account) located in Taiwan depends on whether the creation and perfection of such security complies with Taiwanese law.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Essentially, all cash flowing into the bank account from enforcement forward will not be subject to the pledge or the pledgee’s control unless the pledgor agrees to additionally pledge such cash in favour of the pledgee and notify the account bank of the pledge.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

No. If the pledgee agrees the pledgor to withdraw cash from the bank account, the pledge created over such cash in the bank account will be eliminated.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insololvency proceeding, will Taiwanese insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the receivables have been validly transferred from the seller to the purchaser prior to the seller’s bankruptcy, it is the obligor instead of the seller who is responsible for repaying the receivables. Thus, the purchaser may collect the receivables from the obligor without being affected by the court’s stay order imposed on the seller. Nonetheless, since the future receivables cannot be transferred to the purchaser until such receivables come into existence, once the bankruptcy status of the seller is declared by the court, the receivables arising after the seller’s insolvency will be considered as part of the bankruptcy estate and therefore the purchaser may not collect, transfer or otherwise exercise rights over such future receivables. Further, the bankruptcy administrator may file with the court to rescind the transaction which the seller made with or without consideration before the declaration of the seller’s insolvency if such transaction is deemed being detrimental to rights of the sellers’ creditors. That is, if the transfer by the seller of the receivables to the purchaser is rescinded by the seller’s bankruptcy administrator, the purchaser will not be able to collect the debt from the obligor. The answer above would apply to the purchaser being only a secured party if the security interest, such as pledge over the receivables, has been validly created prior to the bankruptcy of the seller.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Please refer to our response to question 6.1.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insololvency proceeding? What are the lengths of the “suspect” or “preference” periods in Taiwan for (a) transactions between unrelated parties and (b) transactions between related parties?

Under the Bankruptcy Law, within two (2) years from declaration of the bankruptcy of insolvent, the bankruptcy administrator has the right to rescind the insolvent’s following legal acts done within six (6) months prior to declaration of bankruptcy ("Suspect Period"): (i) providing a collateral for outstanding debt obligations, except where the insolvent has committed to provide collateral for such debt obligations before the commencement of the Suspect Period; and (ii) performing the debt obligations undue and not yet payable. The Suspect Period is the same irrespective of whether transactions are made between unrelated parties or related parties.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Essentially, if the purchaser and the seller are separate legal entities under Taiwanese law, there is no legal mechanism available to the bankruptcy administrator under the Bankruptcy Law to consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Taiwan, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only came into existence after the commencement of such proceedings?

As stated in our response to question 6.1, once the bankruptcy status of the seller is declared by the court, the receivables that occur but have not been sold to the purchaser prior to the seller’s insolvency or occur after the seller’s insolvency will be considered as part of bankruptcy estate. The seller is not able to dispose of the property in the bankruptcy estate and the purchaser may not collect, transfer or otherwise exercise rights over such receivables.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Taiwan establishing a legal framework for securitisation transactions? If so, what are the basics?

In Taiwan, there are two major laws relating to securitisation: (i) the Real Estate Securitisation Statute; and (ii) the Financial Assets Securitisation Statute.

1. Real Estate Securitisation Statute

Under the Real Estate Securitisation Statute, there are two mechanisms for securitisation of real estates by way of trust:

(i) Real Estate Investment Trust: under which a real estate investment instruments approved by the Ministry of Finance.

(ii) Real Estate Asset Trust: under which a real estate-related, real estate-related securities, or other investment instruments approved by the Ministry of Finance.

2. Financial Assets Securitisation Statute

Under the Financial Assets Securitisation Statute, there are two mechanisms for a financial institution (the originator) to securitise its financial assets:

(i) Special Purpose Trusts (“SPT”): After grouping together financial assets that have similar characteristics into an asset pool, the originator entrusts the asset pool to a trustee. The trustee in turn sets up an SPT and raises funds by issuing and
(ii) Special Purpose Companies (“SPC”): The Financial Assets Securitisation Statute provides that an SPC must be set up by a financial institution which should not be the originator or the affiliates of the originator, and must have only one single shareholder. The originator transfers its financial assets to the SPC, which raises funds by issuing and offering asset-backed securities to investors. Regarding the administration of the transferred assets, as a principle, the Financial Assets Securitisation Statute forbids an SPC to pledge, transfer, barter, provide as collateral, or otherwise dispose of them. It also requires the SPC to engage a servicer to act as the administrator of the assets, or to place the assets in trust with the servicer. The originator may act as the servicer.

An SPC is established to exclusively conduct asset securitisation business. Therefore, the Financial Assets Securitisation Statute closely restricts SPC’s business activities, in order to prevent attachment or seizure of such financial assets by SPC’s creditors due to its non-performance arising out of other business activities. An SPC may not act as a guarantor or an endorser, and may not engage in any business other than asset securitisation business. Considering the special nature of an SPC, the Financial Assets Securitisation Statute exempts it from many provisions of the Company Act. Also, because an SPC has only one shareholder, a shareholders’ meeting is not necessary, and the provisions concerning shareholders’ meetings stipulated under the Company Act thus do not apply. However, an SPC must still have one to three directors and one to three supervisors, while these positions may not be occupied by the originator, servicer, monitor, or their responsible persons.

7.2 Securitisation Entities. Does Taiwan have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Please see our response to question 7.1.

7.3 Non-Recourse Clause. Will a court in Taiwan give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Generally, such provision will be respected by a Taiwanese court but subject to the limitations on choice of governing law as mentioned in our response to question 2.1.

7.4 Non-Petition Clause. Will a court in Taiwan give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

Generally, such provision will be respected by a Taiwanese court but subject to the limitations on choice of governing law as mentioned in our response to question 2.1.

7.5 Priority of Payments “Waterfall”. Will a court in Taiwan give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Generally, such provision will be respected by a Taiwanese court but subject to the limitations on choice of governing law as mentioned in our response to question 2.1.

7.6 Independent Director. Will a court in Taiwan give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Unless otherwise provided by law, Taiwanese courts generally will give effect to a provision in the articles of incorporation of a company prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of independent directors.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Taiwan, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business within the territory of Taiwan without obtaining an approval from Taiwan government and completing the procedure for branch office registration. There is no definition of “conducting business” under Taiwan law. If a foreign purchaser occasionally purchases, collects, or enforces receivables and the purchase, collection, or enforcement of receivables is not the business activity the purchaser regularly does, it is generally believed that such purchase would not be considered as conducting business in Taiwan although this issue is subject to court test. Basically, the answer would not change even if the purchaser does business with other sellers in Taiwan.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

Basically, neither the seller nor a third party replacement servicer requires a special licence from the government in order to enforce and collect receivables for and on behalf of the purchaser. Nevertheless, if the provision of the services by the seller or the servicer is considered as conducting business in Taiwan, the establishment of a company or branch office in Taiwan may be required.
8.3 Data Protection. Does Taiwan have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Yes. Use or dissemination of data about or provided by obligors would be subject to the Taiwan Personal Data Protection Law (“PDP Law”). The PDP Law was put into effect since 1 October 2012. The PDP Law applies to personal data of individuals only. Basically, data of an enterprise is not protected by the PDP Law.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Taiwan? Briefly, what is required?

Regarding the purchase of consumer loans, please refer to our response to question 4.3. For example, as mentioned in our response to question 1.2, a consumer of a mail order sale can rescind the transaction without cause within seven days from receipt of the goods/services. If the seller transfers the receivables against the consumer but the consumer rescinds the transaction within such period, the purchaser may not collect debt against the consumer.

8.5 Currency Restrictions. Does Taiwan have laws restricting the exchange of Taiwanese currency for other currencies or the making of payments in Taiwanese currency to persons outside the country?

Yes, Taiwan has foreign exchange control pursuant to the Foreign Exchange Control Act and relevant regulations promulgated by the Central Bank of the Republic of China (Taiwan) (the “CBC”). The restrictions of foreign exchange on individual and corporate are as follows:

1. Individual

A Taiwanese individual may, after filing a report with a bank which has been approved by the CBC to operate foreign exchange business, purchase or sell up to US$5 million or its equivalent in foreign currency with New Taiwan Dollars per calendar year without obtaining the CBC’s approval. Any purchase or sale of foreign currency which exceeds the annual quota of US$5 million or its equivalent requires the CBC’s special approval which is granted on a case-by-case basis.

In addition, for any Taiwanese individual to remit out of or into Taiwan an amount equivalent to or exceeding US$500,000, the individual must provide certain information and supporting documents evidencing the remittance to the bank handling the foreign exchange.

2. Corporate

A Taiwanese corporation may, after filing a report with a bank which has been approved by the CBC to operate foreign exchange business, purchase or sell up to US$50 million or its equivalent in foreign currency with New Taiwan Dollars per calendar year without obtaining the CBC’s approval. Any purchase or sale of foreign currency which exceeds the annual quota of US$50 million or its equivalent requires the CBC’s special approval which is granted on a case-by-case basis.

In addition, for any Taiwanese corporation to remit out of or into Taiwan an amount equivalent to or exceeding US$1 million, the corporation must provide certain information and supporting documents evidencing the remittance to the bank handling the foreign exchange.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Taiwan? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Under the Income Tax Act, the payments on receivables by the obligors to the seller or the purchaser will not be subject to withholding tax. Nonetheless, if there is any interest incurred on the payment on receivables, such interest will be subject to withholding tax in the case where the obligor is a corporate entity. The payment obligation of withholding tax is irrelevant to term of receivables to the maturity, or where the seller or the purchaser is located.

9.2 Seller Tax Accounting. Does Taiwan require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

The Business Entity Accounting Act provides that the accounting processes standards for the business entity for items including but not limited to names, format, method of preparation for financial statements and other provisions involving accounting slips, account titles, account books and financial statements commonly used by businesses must be promulgated by the competent authority. Taiwan Regulations Governing Accounting Processing Standards for the Business Entity further provides that business accounting affairs shall be handled in accordance with the generally accepted accounting principles in the absence of explicit provisions in the Business Entity Accounting Act, Regulations Governing Accounting Processing Standards for the Business Entity and all other relevant regulations. Since account receivables are considered as financial assets under Taiwan Statement of Financial Accounting Standards introduced by Financial Accounting Standards Committee, Statement of Financial Accounting Standards No. 34 and No. 36 (both are relating to accounting policies of financial products) will be applicable.

9.3 Stamp Duty, etc. Does Taiwan impose stamp duty or other documentary taxes on sales of receivables?

Under the Stamp Duty Act, stamp duty will only be levied on a contract executed within the territory of Taiwan. If the receivables purchase agreement is executed in Taiwan, such receivables purchase agreement will be deemed as agreement for sale of movable property and therefore be subject to stamp duty of NT$12. In addition, under the Financial Assets Securitisation Statute, for the asset transfer made in accordance with the asset trust securitisation plan approved by the competent authority, the stamp duty and business tax imposed on the asset transfer shall be exempted.

9.4 Value Added Taxes. Does Taiwan impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

Yes. According to the Taiwan Value-added and Non-value-added Business Tax Act, sales of goods and services within Taiwan and importation of goods into Taiwan are subject to value-added tax (“VAT”), which is payable by sellers. Sale of receivables is
generally considered as sale of services. In the event that the purchaser (e.g., an asset management company) gains any profit from the sale of the receivables to the third party or the money collected from the obligors is higher than its purchase price of the receivables, the purchaser will be subject to VAT for such profit. If the services rendered by the collection agent are considered as sales of services under Taiwan taxes laws, fees for such services will be subject to VAT as well.

| 9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections? |

Under Taiwan taxes laws, if the seller is the tax payer and is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sales of goods or services that give rise to the receivables) but fails to pay relevant taxes, the tax authorities cannot make claims against the purchaser or the sold receivables for the unpaid tax.

| 9.6 Doing Business. Assuming that the purchaser conducts no other business in Taiwan, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in Taiwan? |

Under the Income Tax Act, the purchaser will be subject to income tax on any profit made within the territory of Taiwan from sale of receivables to third parties or if the amount collected from obligors is higher than its purchase price of the receivables, even if the purchaser conducts no other business in Taiwan. With respect to the purchaser’s appointing the seller to be its servicer and collection agent, it would not lead to the seller being deemed as the “business agent” of the purchaser as defined under the Income Tax Act to subject the purchaser to tax liabilities in Taiwan.
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Chapter 39

1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

1.2 Consumer Protections. Do Trinidad and Tobago’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) Section 12 of the Money Lenders Act, Chap. 84:04, provides that no person other than a money lender licensed under the Act shall charge interest on loans in excess of 24 per cent simple interest per annum. In practice, this limit is also applied to consumer credit and other receivables transactions.

A money lender does not include any person bona fide carrying on the business of banking or insurance or bona fide carrying on any business not having for its primary object the lending of money, in the course of which, and for the purpose of which, he lends money.

(b) There is no statutory right to interest on late payments prior to judgment. Interest on late payment would normally be a contractual term agreed between the parties. In the absence of a specific contract, the court will usually award interest on a commercial loan at normal overdraft rates up to judgment. Judgment creditors under a money judgment are entitled to interest at the statutory rate of 12 per cent per annum from the date of judgment to the date of payment.

(c) There is no law which permits the cancellation of receivables for a specified period of time. It is to be noted, however, that pursuant to the Bankruptcy Act Chap. 9:70 (“the Bankruptcy Act”), a debtor commits an act of bankruptcy if he gives notice to any of his creditors that he has suspended, or that he is about to suspend payment of his debts.

(d) The Unfair Contract Terms Act, Chap. 82:37, provides certain rights to consumers with respect to debts owed by them; for example, certain liabilities for negligence of the seller/lender cannot be excluded under the terms of the contract.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Contracts by the state or government entities requiring payment of money are normally subject to the consent of the Minister of Finance and/or the Minister having responsibility for the entity. There are also special provisions in statutes governing certain types of loan or financing transactions or specific government entities as well as municipal and regional corporations. Under the State Liability and Proceedings Act, Chap. 8:02, there are restrictions on the remedies which may be granted in proceedings against the state and procedures for the enforcement of such remedies.
2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in Trinidad and Tobago that will determine the governing law of the contract?

If there is no express choice of law in a contract, the court will consider whether it can ascertain that there was an inferred or implied choice of law by the parties, or failing that the court will determine the applicable law by judicial determination of the system of law with which the transaction has the closest and most real connection. For example, if the parties agree that arbitration shall take place in a particular country or that the courts of a particular country will have jurisdiction over the contract, that is a strong inference that the parties have impliedly chosen the law of that country as the proper law. Where no such choice can be inferred, the court will hold the contract to be governed by the law of the country with which the transaction is most closely connected.

2.2 Base Case. If the seller and the obligor are both resident in Trinidad and Tobago, and the transactions giving rise to the receivables and the payment of the receivables take place in Trinidad and Tobago, and the seller and the obligor choose the law of Trinidad and Tobago to govern the receivables contract, is there any reason why a court in Trinidad and Tobago would not give effect to their choice of law?

No, there is not.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in Trinidad and Tobago but the obligor is not, or if the obligor is resident in Trinidad and Tobago but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in Trinidad and Tobago give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

Where the parties expressly stipulate that a contract is to be governed by a particular law, that law will be the proper law of the contract. This freedom of choice is subject to some limitations. The selection of a foreign law must be bona fide and legal (at least under Trinidad and Tobago law if a Trinidad court is required to adjudicate on this issue) and there must be no reason for avoiding the choice on the grounds of public policy. Express selection of a foreign law will not prevent the application of mandatory provisions of any local law which would normally have been applicable to the transaction but for the parties’ choice of foreign law.

2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in Trinidad and Tobago?

No, it is not.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does Trinidad and Tobago’s law generally require the sale of receivables to be governed by the same law as the governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., Trinidad and Tobago’s laws or foreign laws)?

No, it does not.

3.2 Example 1: If (a) the seller and the obligor are located in Trinidad and Tobago, (b) the receivable is governed by the law of Trinidad and Tobago, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of Trinidad and Tobago to govern the receivables purchase agreement, and (e) the sale complies with the requirements of Trinidad and Tobago, will a court in Trinidad and Tobago recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insololvency administrators of the seller and the obligor)?

Yes. A court in Trinidad and Tobago will recognise the sale as being effective against the seller, the obligor and other third parties (such as creditors or insololvency administrators of the seller and the obligor). An exception is where on insolvency of the seller, a court may deem the sale to be a fraudulent preference of the buyer in the case where the consideration for the sale consisted of, or included, settlement of a debt owed by the buyer to the seller. See a further explanation in our answers to questions 6.1, 6.2 and 6.3 below.

3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside Trinidad and Tobago, will a court in Trinidad and Tobago recognise that sale as being effective against the seller and other third parties (such as creditors or insololvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

Subject to the exception noted in our answer to question 3.2, the courts in Trinidad and Tobago will recognise the sale as being effective against the seller and other third parties (such as creditors or insololvency administrators of the seller). An exception is where on insolvency of the seller, a court may deem the sale to be a fraudulent preference of the buyer in the case where the consideration for the sale consisted of, or included, settlement of a debt owed by the buyer to the seller. See a further explanation in our answers to questions 6.1, 6.2 and 6.3 below.

3.4 Example 3: If (a) the seller is located in Trinidad and Tobago but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in Trinidad and Tobago recognise that sale as being effective against the seller and other third parties (such as creditors or insololvency administrators of the seller) without the need to comply with Trinidad and Tobago’s own sale requirements?

Subject to the exception noted in our answer to question 3.2, the courts in Trinidad and Tobago will recognise the sale as being effective...
4 Asset Sales

4.1 Sale Methods Generally. In Trinidad and Tobago what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

The sale of receivables is generally effected by way of a Factoring Agreement or an Assignment Agreement so as to vest in the assignee the legal right to the debt and all the remedies therefor with power to give a good discharge without the concurrence of the seller.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

(i) Notice is necessary to make the obligor liable to the assignee. Accordingly, notice of the assignment must be given to the obligor by the purchaser.

(ii) Stamp duty is chargeable and payable in respect of the sale of the receivables (see our response to question 9.3 below; for details).

Yes, with respect to both a legal and equitable assignment, in order to make the assignee’s title effective against the obligor, notice of the assignment must be given to the obligor though no assent or acquiescence on the part of the obligor is necessary. The assignee takes subject to all equities existing between the assignor and the obligor up to the date of giving notice of the assignment.

(a) The answer to the question does not vary if the receivables contract does not prohibit assignment but does not expressly permit assignment.

(b) If the receivables contract expressly prohibits assignment by the party entitled to the benefit thereof, then an assignment thereof without the obligor’s consent is ineffective to vest the contractual rights in the assignee even after notice of the assignment is given to the obligor. The obligor remains liable to the assignor and obtains a good discharge by payment to him. Further, the assignee takes subject to all equities between the assignor and the obligor arising at any time, e.g., a right of set-off arising after notice of assignment is given. Accordingly, the consent of the obligor must be obtained for assignment of the contractual rights. However, unless by the terms of the contract the restriction clearly extends to the debt arising from performance of the contract, the debt is assignable without the obligor’s consent and is enforceable by the assignee once notice has been given to the obligor.

The giving of notice of the assignment to the obligor cuts off obligor set-off rights and other obligor defences arising after the date of notice. An assignee of a chose in action takes subject to all

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Promissory Notes

A promissory note is a negotiable instrument and is transferable by the endorsement of the note.

Mortgage Loans

Normally the sale would be effected by a Deed of Assignment whereby the debt and the real property securing the same are transferred to the purchaser. Stamp duty is chargeable and payable on the deed at the rate of 0.05 per cent of the consideration. The Deed of Assignment must be registered in the Deeds Registry.

Consumer Loans

Same as the response to question 4.2.

 Marketable Debt Securities

The sale would be effected by the seller and purchaser executing a standard form transfer and seller delivering the certificate to the certificate to the purchaser. Upon delivery of these documents to the Registrar or Trustee, a new certificate is issued in the name of the purchaser and his name will be recorded as holder of the security.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Yes, it will.
Although most of the above applies to facultative agreements, these agreements typically have a different legal structure. In a facultative agreement, the factor, who in some respects is like a banker, has no right to give notice to the obligor. The factor is entitled to keep the receivables until the obligor is paid, and only then is the obligor entitled to receive payment. The factor has no rights of set off and other defences which were available against the assignor, subject to this exception, that after notice of the assignment is given the debtor by payment or otherwise cannot do anything to take away or diminish the rights of the assignee as they stood at the time of the notice.

The giving of notice to the obligor also gives priority to the assignee against any competing interests for the same debt. Notice also:

(i) fixes the rights of the parties in relation to the debtor’s countervailing rights;

(ii) prevents the discharge of the debtor by subsequent payment to the client/seller;

(iii) avoids changes in terms in the contract of sale (which have not been authorised by the factor/assignee) being enforceable against the factor; and

(iv) enables the factor to take proceedings for recovery of the debt in his own name.

Apart from the need for a “written” notice in the case of a statutory assignment, the notice may take any form. All that is required is that the debtor should be given to understand that the debt has been made over by the creditor to some third party. However the “notice” must clearly indicate that this has occurred and therefore ambiguous notices will not qualify as “notices”. Generally, notice must be given at the time of, or after, the assignment/sale has occurred.

A notice may be delivered after insolvency proceedings are commenced against the seller where the agreement between the seller and factor is of a whole turnover type and is made prior to the commencement of the proceedings, subject to the exception set out in our answer to question 3.2. In such an agreement the ownership of the debts vests in the factor from the date of the agreement. These debts will include not only those debts notified to him but all those specified in the agreement and earned by the performance of the relevant contract of sale or service by the company. In respect of any such invoiced debts not notified to him, the factor may exercise all rights of ownership, including the giving of notice to debtors and collection.

With a facultative type of agreement the factor has no rights of ownership at all to any debts not offered to him even if they are earned by performance of the contract of sale or service before the commencement of the insolvency proceedings. Accordingly he has no right to give notice to the obligor in respect of debts which have not been offered to him and accepted prior to the insolvency proceedings. Any notice given to the debtor after the commencement of insolvency proceedings against it is ineffective. As from the date of the commencement of the insolvency proceedings the company must cease to carry on its business except for the purpose of its beneficial winding up.

The expressions “whole turnover agreement” and “facultative agreement” are explained in our answer to question 4.10 below.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in Trinidad and Tobago? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If Trinidad and Tobago recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Restrictions in receivables contracts prohibiting the sale or assignment of the contract are generally enforceable in Trinidad and Tobago. A sale by the seller in breach of the prohibition is invalid against the obligor. The obligor remains liable to the original seller. Any notice that the assignee gives to the obligor will have no effect. The obligor would be entitled to terminate the contract on account of the seller’s breach and to recover damages for any loss that he has suffered as a consequence.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

The sale document must contain sufficient information so as to identify clearly each of the debts to be sold. The information required would normally include the name of the obligor and details of the invoice or another document evidencing the debt, i.e.; invoice number, invoice date, payment date, the amount of the indebtedness thereunder and a brief description of the goods or services provided by the seller.

The receivables sold do not have to share objective characteristics but may be a mixed basket of different types of debts. However, to the extent that stamp duty is payable on the sale document it may be advantageous to group the receivables into different categories according to the rate or rates of duty applicable to each category and apportion the consideration appropriately. In a “whole turnover agreement” where the seller agrees to sell and the purchaser agrees to buy all the seller’s receivables, the sale by the seller of “all” of its debts to the purchaser is sufficient identification of the receivables.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

The authorities suggest that documents drawn up by the parties to record a sale transaction have almost always been accepted as such
where the court has been satisfied that they genuinely reflected the intention of the parties, even though the terms used in operating the agreement were such as would ordinarily suggest a loan on security rather than a purchase. The authorities further suggest that the courts are inclined to recognise the right of businessmen to use the business language they understand without having this interpreted as if it were a legal dictionary. This does not prevent the court from investigating the transaction to determine whether it is truly a sale.

(a) The seller may retain credit risk by providing in the sale agreement for a right of recourse by the purchaser against the seller in the event of default by the obligor.

(b) The seller may retain interest rate risk by indemnifying the purchaser against any decline in the interest rate.

(c) The seller may retain control of collection of the receivables by collecting the same as the agent for the purchaser.

(d) The sale agreement may provide for the repurchase of the debt by the seller in certain circumstances including, but not limited to, the following: (i) where the existence of the debt is disputed by the debtor; (ii) where the debtor’s/customer rejects the goods and/or services the subject matter of the purchased debt; (iii) where the debtor disputes his liability to pay the debt or any part of it and gives as a reason for such dispute any alleged breach by the seller of the contract; (iv) or the existence of any set off or counterclaim or right to a deduction or any matter which would constitute a breach by the seller of its warranties or covenants in relation to such debt; (v) or if the seller shall accept the return of any goods the subject of a purchased debt; or (vi) if the seller shall be or become liable to pass any credit to a customer in respect of the purchased debt.

4.9 Continuous Sales of Receivables. Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

Yes it can. See our answer to question 4.10.

4.10 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

Yes. In a “whole turnover agreement” there is no distinction between receivables that arise prior to, or after, the seller’s insolvency since the transfer of the debts occurs at the date of the agreement and is effective without a further transfer document as soon as the debt comes into existence. In a “facultative agreement”, the seller periodically offers his debts for sale to the purchaser and the purchaser may either accept or decline the offer. The transfer/sale of the debt occurs only when the seller’s offer is accepted by the purchaser. Therefore, in the event of the seller’s insolvency a fixed charge over his debts in favour of a third party subsequent to the date of the facultative agreement will have priority over a later assignment made in furthurance of the facultative agreement.

4.11 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

The Assignment document will normally provide for the transfer of the receivables together with all rights and remedies relating to or for enforcing the same including any related security. Once there is a related security, which is also assigned, the assignment must be effected by Deed. If the related security is real property or an interest in real property the Deed of Assignment must be registered in the Deeds Registry.

5 Security Issues

5.1 Back-up Security. Is it customary in Trinidad and Tobago to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

No. However it is open to the purchaser out of an abundance of caution to take a security interest in the receivables.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of Trinidad and Tobago, and for such security interest to be perfected?

The security interest may normally be effected by (i) an assignment by way of charge, or (ii) a fixed equitable charge on the receivables made by the seller in favour of the purchaser. An equitable charge should normally be supported by an obligation to deposit the receivables into an account controlled by the charge, otherwise the charge may be deemed only a floating charge. The Deed of Assignment or Deed of Charge is subject to stamp duty at the rate of 0.4 per cent of the amount secured.

If the seller is a company, the purchaser must, within 30 days after the creation of the security interest, register with the Registrar of Companies a statement of charge which sets out certain statutory particulars regarding the security interest together with a copy of the instrument by which the security interest is created. The statement of charge is registered in the official file of the seller.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in Trinidad and Tobago to grant and perfect a security interest in purchased receivables governed by the laws of Trinidad and Tobago and the related security?

The same security documents and formalities as set out in the response to question 5.2 above will apply. Assuming that the purchaser is a Trinidad and Tobago company the statement of charge is registered in the official file of the purchaser. Notice of any further assignment must be given to the obligor.
5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of Trinidad and Tobago, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in Trinidad and Tobago or must additional steps be taken in Trinidad and Tobago?

Yes. If the purchaser is an overseas company no formalities are required in Trinidad and Tobago except that notice of any further assignment must be given to the obligor. If the purchaser is a Trinidad and Tobago company a statement of charge must be registered in the official file of the purchaser and notice of any further assignment given to the obligor.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

No additional or different requirements apply except in the case of a loan secured by a mortgage of real property. In that case the Deed of Mortgage or Deed of Assignment of Mortgage must be registered in the Deeds Registry.

5.6 Trusts. Does Trinidad and Tobago recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Trinidad and Tobago law recognises the concept of trust.

5.7 Bank Accounts. Does Trinidad and Tobago recognise escrow accounts? Can security be taken over a bank account located in Trinidad and Tobago? If so, what is the typical method? Would courts in Trinidad and Tobago recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Trinidad and Tobago?

Trinidad and Tobago recognises escrow accounts. A charge on the interest of a Trinidad party in an escrow account is effective over the charger’s interest therein, subject however to the terms and conditions governing the escrow.

Security can be taken over a bank account located in Trinidad and Tobago. The typical method is a specific account charge or a general charge under a charging document such as a debenture on the property of a company.

The courts in Trinidad and Tobago would recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in Trinidad and Tobago. If the charger is a Trinidad company, a statement of charge must be registered in the official file.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Yes, the secured party is entitled to control all cash flowing into the bank account after enforcement until the secured party is repaid in full. It is normal practice to provide in the document which creates the charge over the account that the secured party is irrevocably authorised without notice to the owner of the account to appropriate the whole or part of the funds in, or towards, payment or discharge of any or all of the secured indebtedness.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

In Trinidad and Tobago security over a bank account can be created by way of fixed or floating charge. A floating charge is not a very effective form of security as there would be little or no restriction on withdrawals from the account by the account holder prior to the floating charge being crystallised into a fixed charge. As a consequence it is normal practice in Trinidad and Tobago that a charge over a bank account is created by a fixed charge under which the secured party has effective control over the account. In particular the charge would include a provision which prohibits the owner of the account from withdrawing the funds in the account without the consent of the secured party. See also the answer to questions 5.7 and 5.8 above.

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will Trinidad and Tobago’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

Neither the Companies Act, Chap. 81:01, (“Companies Act”) nor the Bankruptcy Act provide for an “automatic stay”. Under section 436 of the Companies Act certain transactions relating to property which would, if made or done by, or against an individual, be deemed in his bankruptcy a fraudulent preference, or a fraudulent conveyance, assignment, transfer, sale or disposition, shall if made or done by or against a company, be deemed, in the event of its being wound up, a fraudulent conveyance, assignment, transfer, sale or disposition, as the case may be and be invalid accordingly.

Section 48 (1) of the Bankruptcy Act provides that every conveyance or transfer of property, or charge thereon made, every payment made, every obligation incurred, and every judicial proceeding taken by any person unable to pay his debts as they become due from his own money in favour of any creditor, or of any person in trust for any creditor, with a view to giving such creditor, or any surety or guarantor for the debt due to such creditor, a preference over the other creditors, shall, if the person making, taking, paying or suffering the same is adjudged bankrupt on a petition presented within three months after the date of making, taking, paying or suffering the same, be deemed fraudulent and void as against the trustee in bankruptcy.

The Insolvency Official does not have any inherent power to stay collection and enforcement actions but must seek assistance from the court as provided in the response to question 6.2 below.

The provisions relating to fraudulent preferences apply to sales and charges. Therefore, the transaction may be set aside as a fraudulent preference whether deemed a sale or a security.
6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the Insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

The Insolvency Official may apply to the court for an injunction to prohibit or stay the purchaser’s exercise of rights on the ground that the transaction is a fraudulent preference. The purchaser will be entitled to contest the application. The court has the discretion whether or not to grant the injunction, stay or any other appropriate relief. In urgent cases interim injunctions may be granted. The Insolvency Official may, subject to the provisions of the Companies Act, also disclaim the agreement as an unprofitable contract.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the Insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the Insolvency proceeding? What are the lengths of the "suspect" or "preference" periods in Trinidad and Tobago for (a) transactions between unrelated parties and (b) transactions between related parties?

The following conditions must be fulfilled:

1. The seller must, at the date of the transaction, be unable to pay from his own money his debts as they fall due.
2. The transaction must be in favour of a creditor, or some person in trust for a creditor.
3. The seller must have acted with the view of giving such creditor a surety or guarantor for the debt due to such creditor a preference over his other creditors.
4. The seller must be adjudged insolvent on a petition presented within three calendar months after the date of the transaction sought to be impeached.

Pursuant to sections 48 of the Bankruptcy Act and 436 of the Companies Act, the “suspect” or “preference” period is three months before the commencement of the insolvency proceedings of the company. There is no distinction made in the legislation between related and unrelated parties with respect to the preference period. For the purposes of this section, the commencement of the winding up is deemed to correspond with the presentation of the bankruptcy petition in the case of an individual.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the Insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in insolvency proceeding?

There is no provision for the consolidation of assets and liabilities of the purchaser with those of the seller or its affiliates in insolvency proceedings by the Insolvency official.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in Trinidad and Tobago, what effect do these proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) sales of receivables that only come into existence after the commencement of such proceedings?

In a facultative agreement (discussed in our response to question 4.10 above), the transfer of the future receivables occurs when the seller’s offer to sell a specific receivable is accepted by the purchaser. Hence the purchaser’s right to the future receivables arises only at the time of the sale of the debts in furtherance of the facultative agreement. Therefore, where the sale of the receivables has not occurred on the initiation of insolvency proceedings, the receivables remain the property of the seller and will on application by the liquidator, vest in the liquidator.

In a “whole turnover agreement” the purchaser is entitled to the ownership of the debts vesting in him at the time of the order or resolution for insolvency. These debts will include, not only those debts notified to him, but also all those debts specified in the agreement and earned by the performance of the relevant contract of sale or service by the company. Debts earned by performance by the liquidator in compulsory or creditors’ voluntary liquidation will not vest in the purchaser even if they arise under contracts in existence before the liquidator’s appointment.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in Trinidad and Tobago establishing a legal framework for securitisation transactions? If so, what are the basics?

No. However some provisions of the Securities Industry Act 2012 (Securities Act) may be applicable to securitisation transactions to the extent that any such transactions involve the sale or offer for sale or distribution of securities (as defined in the Securities Act). The Securities Act provides for regulatory oversight by the Trinidad and Tobago Securities and Exchange Commission in relation to the trading in asset backed securities by way of the grant of exemptions from the issue of a prospectus.

7.2 Securitisation Entities. Does Trinidad and Tobago have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

No, it does not.

7.3 Non-Recourse Clause. Will a court in Trinidad and Tobago give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

The Trinidad and Tobago courts will enforce a contract governed by foreign law limiting the recourse of parties to available funds once they are satisfied that the relevant provisions are valid and enforceable under the foreign law and such enforcement would not be illegal under Trinidad and Tobago law or contrary to local public policy. In that context such a non-recourse provision will be enforced.

7.4 Non-Petition Clause. Will a court in Trinidad and Tobago give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

In the context of enforcement of foreign law contracts discussed at question 7.3 above, a provision prohibiting the parties from taking
legal action against the purchaser or another person will be enforced by the Trinidad and Tobago courts. There may be some doubt as to enforceability of a provision prohibiting commencement of an insolvency proceeding against the purchaser or another person (see our response to question 7.6 below).

7.5 Priority of Payments “Waterfall”. Will a court in Trinidad and Tobago give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

Yes. A court in Trinidad and Tobago will normally give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract. A possible exception would be the case discussed in our answer to question 3.2 above where on insolvency of a Trinidad and Tobago seller a court may deem the contract to be a fraudulent preference of the creditors to whom the distribution is made.

7.6 Independent Director. Will a court in Trinidad and Tobago give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Yes. A Trinidad and Tobago court will normally enforce a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions without the affirmative vote of an independent director. However, an undertaking not to commence or a restriction against commencement of insolvency proceedings may be unenforceable. Firstly, directors may incur personal liability to creditors and shareholders if an insolvent entity continues trading so that a court is unlikely to prevent them from instituting insolvency proceedings in a proper case. Secondly, such an undertaking or restriction may be considered to be against public policy.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in Trinidad and Tobago, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in Trinidad and Tobago? Does the answer to the preceding question change if the purchaser does business with other sellers in Trinidad and Tobago?

Except for entities that, by reason of the nature of their business, are subject to licensing or minimum capitalisation requirements there are no qualification criteria for an entity to do business in Trinidad and Tobago. A single transaction involving the purchase and ownership of specific receivables by a non-resident purchaser who has no other business in Trinidad and Tobago, will not be deemed as carrying on business in Trinidad and Tobago, nor will the purchaser be subject to regulation as a financial institution. If the non-resident purchaser engages in several similar transactions with different sellers or enters into a transaction for continuous purchase of receivables for an extended period from the same seller, it is likely that he would be deemed to be carrying on (i) business in Trinidad and Tobago for tax purposes, and (ii) business of a financial nature under the Financial Institutions Act which requires a licence under that Act.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

No licence is required by the seller under Trinidad and Tobago law. Once notice of assignment has been given to the obligor the seller is not entitled to collect or enforce in his own right and would have to be acting as an agent of the purchaser.

8.3 Data Protection. Does Trinidad and Tobago have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

One of the fundamental rights under the Constitution of Trinidad and Tobago is an individual’s right to privacy. There are some limited privacy rights under common law. The banker/client relationship also gives rise to obligations of confidentiality on the part of the Bank. There are no laws in Trinidad and Tobago which specifically deal with the use or dissemination of data provided by obligors. The Data Protection Act 2011 provides, inter alia, for the protection of personal privacy and information by the private sector, the government and public authorities.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of Trinidad and Tobago? Briefly, what is required?

There are no applicable laws in Trinidad and Tobago except that local banks have adopted a Code of Banking Practice for dealings with customers that includes some provision for a general duty of confidentiality towards their customers.

8.5 Currency Restrictions. Does Trinidad and Tobago have laws restricting the exchange of Trinidad and Tobago’s currency for other currencies or the making of payments in Trinidad and Tobago’s currency to persons outside the country?

There are no exchange control restrictions in Trinidad and Tobago. Payments in Trinidad and Tobago currency are made locally and payments to persons outside the country are made in foreign currency.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in Trinidad and Tobago? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Yes. Interest paid by a resident obligor to a non-resident purchaser is subject to withholding tax which is required to be deducted at source by the payer and paid to the revenue authority. The standard rate of
withholding tax is 15 per cent or such lower rate as may be provided in any double taxation treaty between Trinidad and Tobago and the purchaser’s country of residence. The receivables contract will often provide for grossing up payments that are subject to withholding tax so that after deduction of withholding tax at the applicable rate the payee will receive the specified amount of interest. In the absence of a grossing up provision the payee will receive the specified amount minus the tax. Where there is a double taxation treaty the payee may be entitled to a tax credit in his country of residence for the tax deducted and paid in Trinidad and Tobago.

9.2 Seller Tax Accounting. Does Trinidad and Tobago require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

No, it does not.

9.3 Stamp Duty, etc. Does Trinidad and Tobago impose stamp duty or other documentary taxes on sales of receivables?

Yes. A Deed of Assignment is chargeable with stamp duty as a Conveyance on Sale at rates varying between two per cent, five per cent and seven per cent of the consideration. Some receivables may be exempt from stamp duty, e.g., promissory notes or debt instruments or securities of specifically exempted entities, and others, e.g., mortgage loans or bonds, may be subject to a different rate of 0.5 per cent. In such cases it is recommended that separate considerations for each different type of security be stated in the assignment in order to take advantage of such exemptions or lower rate.

9.4 Value Added Taxes. Does Trinidad and Tobago impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

The Value Added Tax Act (“the Act”) imposes value added tax (“VAT”) at the rate of 15 per cent on the sale of goods and services by a registered supplier. A supplier in receipt of gross sales or income in excess of TT$ 360,000 in a twelve-month period is required to register under the Act. The sale of receivables is deemed a “financial service” under the Act and is VAT exempt. The services of the collection agent are subject to VAT once he is registered under the Act.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

VAT is not chargeable. Stamp duty is payable by the purchaser. The taxing authority will not make claims for the unpaid duty against the purchaser or the sold receivables or collections but the Deed of Assignment cannot be received, filed, used or admitted into evidence in a Trinidad court until it is properly stamped. Therefore, in the event of a dispute the purchaser will have difficulty in establishing his title to the receivables or collections if the Deed of Assignment or other applicable transaction documents are unstamped.

9.6 Doing Business. Assuming that the purchaser conducts no other business in Trinidad and Tobago, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors make it liable to tax in Trinidad and Tobago?

The sale of receivables constitutes the sale of an asset in Trinidad and Tobago. No income tax or corporation tax is payable by the purchaser on transaction gains so long as the purchaser is not deemed to be carrying on business here. We have discussed the issue of the payment of withholding tax above.

Cautionary Statement

The Parliament of Trinidad and Tobago has enacted the Bankruptcy and Insolvency Act 2007 which repeals the Bankruptcy Act. The new act will come into force on proclamation but it has not yet been proclaimed and we have no indication when this will be done. We caution that the provisions of the new act, when proclaimed, may require variation of the responses to some of the questions herein, especially those relating to bankruptcy or insolvency of a party.
David Clarke joined the firm in 1969. He represents the firm’s clients in a wide range of commercial transactions, in particular the establishment of large commercial or industrial projects including: the preparation and approval of material project contracts on behalf of project parties; project financing through local and international lenders; mergers and acquisitions; joint ventures; takeovers; land development projects; insurance; and corporate governance. David renders general corporate or commercial advice and advice on environmental issues. He also acts for both lenders and borrowers in a range of facilities in banking and finance.

Donna-Marie Johnson joined the Corporate + Commercial department of J.D. Sellier in March 2008 as a Senior Associate and offers years of valuable experience. Having worked for various organisations for most of her career, she has a clear understanding of an organisation’s needs and the Corporate Attorney’s deliverables to the corporate client. Ms. Johnson also heads the Estate Planning and Administration department at J.D. Sellier.

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1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

Under Article 130 of the Civil Code, a contract is formed upon the acceptance of an offer by the offeree, and so, on this basis, an enforceable debt obligation can be deemed to exist if an offer and acceptance can be established. According to Article 132 of the Civil Transactions Law (5/1985), expressions of will can also be made both verbally or in writing.

This being said, according to the Civil Code, some kinds of contract must be in writing in order to be valid and enforceable. This is certainly the case in respect of any contract for the sale or purchase of a ship or the sale of land. In the UAE, the evidential burden in this respect will be governed by the Law of Evidence (10/1992), which requires that both official and unofficial documents must be signed, stamped and in their original form.

In light of the above, and in order to have an enforceable debt obligation in the UAE, a contract should be executed and witnessed appropriately.

1.2 Consumer Protections. Do the UAE’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

Under the Shari’ah, which is the paramount body of law in the UAE, the charging and payment of interest, whether simple or compound, is prohibited. This is also the case under Article 714 of the UAE Civil Code.

However, interest is permitted under Article 88 of the Commercial Code, which allows for the charging of interest in late payment circumstances and under Article 76 of the Commercial Code which states that a creditor may include interest provisions in a commercial loan agreement. If the creditor fails to do so, the current market interest rate will apply to the contract although this cannot exceed 12 per cent.

Article 91 of the Commercial Code also provides for circumstances where a creditor can claim a supplementary indemnity in addition to interest in circumstances where the creditor suffered loss or damages due to a debtor’s gross negligence or wilful misconduct. Currently there are no consumer protections of this nature in place.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Although local legislation does not differentiate between private and government related receivables, there are certain specific regulatory risks which apply in relation to dealing with sovereign assets. The sale of any governmental receivables will always be subject to a Royal decree.

2 Choice of Law – Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the UAE that will determine the governing law of the contract?

In the UAE, when no law is specified, and it is possible to create a link between the UAE and the receivables contract whether by virtue of the place of contract performance or the residence of the contracting parties, for example, then the UAE courts will determine the contract from a UAE perspective.

It should also be noted, however, that the UAE is also party to the New York Convention, which recognises foreign law and arbitration awards from other countries. On this basis such awards should be enforceable in the UAE.

2.2 Base Case. If the seller and the obligor are both resident in the UAE, and the transactions giving rise to the receivables and the payment of the receivables take place in the UAE, and the seller and the obligor choose the law of the UAE to govern the receivables contract, is there any reason why a court in the UAE would not give effect to their choice of law?

In the aforementioned circumstances, generally the UAE courts would apply UAE law exclusively. However, on 31 October 2011, Law No. 16 of 2011, amending Law No. 12 of 2004, was enacted, which grants exclusive jurisdiction to the DIFC Court of First Instance to hear and determine civil or commercial claims and actions to which the DIFC or any DIFC Body, DIFC Establishment
or Licensed DIFC Establishment is a party. In light of this, if any aspect of the transaction involves the DIFC, DIFC Laws and DIFC Regulations would potentially have effect.

### 2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor
If the seller is resident in the UAE but the obligor is not, or if the obligor is resident in the UAE but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the UAE give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In theory, parties are free to choose foreign law and the governing jurisdiction to govern their receivables contracts pursuant to the provisions of the UAE Civil Code; however, in practice, this may be more difficult.

In circumstances where there is a link with the UAE (in this case the seller), but the receivables contract is subject to foreign law and, following overseas litigation, a party is seeking to enforce an overseas judgment in the UAE, recognition of the judgment by the courts in the UAE is not definite. It is possible that the UAE courts will not give credence to the judgment and will interpret the contract from a UAE perspective.

As previously mentioned, due to the UAE’s ratification of the New York Convention, the UAE should recognise foreign law and arbitration awards from other countries that are a party to the convention and, on this basis, such awards should be enforceable in the UAE.

Article 235 of Federal Law 11 of 1992 governs the enforcement of foreign judgments in the UAE and outlines the pre-requisites for enforcement. The most relevant of these are that: (i) a foreign court would recognise a ruling of a UAE court in similar circumstances to the request made to the UAE court (Article 235(1)); (ii) the courts of the UAE did not have jurisdiction in the dispute that gave rise to the foreign courts award (Article 235(2)(b)); (iii) the foreign ruling is a final award (Article 235(2)(d)); and (iv) the award does not conflict with a ruling issued by a UAE court or contravene local public order (Article 235(2)(c)).

### 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in the UAE?
At the time of writing this chapter, the UAE have not yet ratified the United Nations Convention on the International Sale of Goods.

### 3 Choice of Law - Receivables Purchase Agreement

#### 3.1 Base Case. Does the UAE’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., UAE’s laws or foreign laws)?

The laws of the UAE do not require the sale of receivables to be governed by the same law as the law governing the receivables themselves. However, in reality, if either the sale of the receivables or the receivables themselves are governed by the laws of the UAE, the UAE courts will claim jurisdiction unless there is a connection to the DIFC.

#### 3.2 Example 1: If (a) the seller and the obligor are located in the UAE, (b) the receivable is governed by the law of the UAE, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the UAE to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the UAE, will a court in the UAE recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

If both the receivables and the purchase agreement are governed by the laws of the UAE, then the UAE courts will recognise the choice of law and apply UAE law. If all formalities have been adhered to and the sale complies with local law requirements, then the sale, in theory, should be recognised as being effective against the seller, the obligor and other third parties.

#### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside the UAE, will a court in the UAE recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor’s country or the purchaser’s country (or both) be taken into account?

If the receivables and the purchase contract are governed by the laws of the UAE, then the location of one of the parties outside of the UAE is only relevant in so far as the party based outside of the UAE can try to pursue an action in that non-UAE jurisdiction. The UAE courts and other adjudicatory authorities will interpret the sale from a UAE law perspective and apply UAE law. Adherence to foreign law requirements of the parties based outside the UAE will not necessarily be taken into account unless such requirements are compatible with the laws of the UAE. This is usually evidenced by a legal expert witness from that jurisdiction testifying to the compatibility.

If all formalities have been adhered to and the sale complies with local law requirements then the sale, in theory, should be recognised as being effective against the seller and other third parties.

#### 3.4 Example 3: If (a) the seller is located in the UAE but the obligor is located in another country, (b) the receivable is governed by the law of the obligor’s country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor’s country, will a court in the UAE recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the UAE’s own sale requirements?

As previously mentioned, the UAE courts do recognise the choice of foreign law, however this will often be interpreted in the context of UAE legislation. If the sale complies with the requirements of the obligor’s country, there is no guarantee that such sale will be recognised as being effective under the laws of the UAE. The UAE courts will consider the sale from a UAE law perspective.
In circumstances where a judgment has been enforced in the obligor and purchaser’s country in respect of the sale, the ability of the obligor to enforce a foreign judgment will be subject to the discretion of the UAE courts. The parameters as to how they exercise their discretion are outlined above in question 2.3.

3.5 Example 4: If (a) the obligor is located in the UAE but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in the UAE recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with the UAE’s own sale requirements?

The UAE courts do recognise the choice of foreign law, however this will often be interpreted in the context of UAE legislation. If the sale complies with the requirements of the seller’s country, there is no guarantee that such sale will be recognised as being effective under the laws of the UAE. The UAE courts will consider the sale from a UAE law perspective.

In circumstances where a judgment has been enforced in the seller’s country in respect of the sale, the ability of the obligor to enforce a foreign judgment will be subject to the discretion of the UAE courts. The parameters as to how they exercise their discretion are outlined above in question 2.3. Needless to say, if an arbitral award is issued by a New York Convention signatory, then the UAE courts will enforce the arbitral award pursuant to the terms of the New York Convention in recognition of arbitral standards.

3.6 Example 5: If (a) the seller is located in the UAE (irrespective of the obligor’s location), (b) the receivable is governed by the law of the UAE, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in the UAE recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in the UAE and any third party creditor or insolvency administrator of any such obligor)!

In this instance the seller’s country is the UAE and the receivables are governed by the laws of the UAE, as such the receivables will be interpreted in line with the laws of the UAE and so would have to comply with the requirements of the UAE.

The UAE courts do recognise the choice of foreign law, however this will often be interpreted in the context of UAE legislation. As a result of this the purchase contract itself would be interpreted in line with the laws of the UAE.

If the sale complied with the requirements of the purchaser’s country, this would be relevant in so far as such sale was consistent with the UAE’s own sale requirements. This would also be the case when determining if the sale is effective against the seller.

In circumstances where the purchaser, based in another jurisdiction, is able to demonstrate that the sale is effective in his/her own jurisdiction and is awarded a judgment to that effect, it will be up to the purchaser to demonstrate in front of the UAE courts that such judgment is transferable and should be awarded in the UAE.

In the UAE, the most common form of sale is an assignment of receivables which allows for the transfer of all rights, title, interests, benefit and entitlement from the seller to the purchaser.

4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

For perfection to take place in the UAE, actual possession and control is required as a prerequisite. Traditionally loans in the UAE are repaid by the borrower through the provision of post-dated cheques. Following the sale of receivables, these post-dated cheques are then transferred to the purchaser of the receivables.

4.3 Perfection for Promissory Notes, etc. What additional or different formalities for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

In the UAE, promissory notes should contain the promissory condition with the undertaking for payment of a certain amount of money written in figures and words. The document should also contain the date of maturity, the place where the promissory note will be effected, the names of the relevant parties and the date and place of issue of the note itself. The note should also be signed by the person issuing the note. The failure to adhere to these principals means that the note is in violation of Article 591 of the Commercial Transactions Law, Federal Law No. 18 of 1993.

Under the Civil Code, a mortgage loan must be registered. The date and time of this registration will determine the priority in respect of creditors. Mortgages over real property must also be in writing.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

In order to give effect to a sale of receivables and for such sale to be effective, the obligor must be issued with notice and provide the seller and/or purchaser with an acknowledgment of such notice accepting the terms and conditions of the sale. This acknowledgment must then be returned to the purchaser. The answer is also dependent upon the underlying agreement in respect of the receivables. If the receivables contract is silent then
it is customary for notice to be provided as a means to achieve assumed compliance, enforceability and good customer relations. If the receivables contract expressly prohibits an assignment, then such a prohibition can only be circumvented with the express permission of the obligors. In circumstances where the underlying contract expressly provides for assignment, then consent from the obligors will not be required.

### 4.5 Notice Mechanics

If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

This will depend entirely upon the notice provisions of the underlying contracts in relation to the receivables as there is no legislation pertaining to notice mechanics in the UAE.

### 4.6 Restrictions on Assignment; Liability to Obligor

Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in the UAE? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the UAE recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

In order to give effect to an assignment of contract receivables, an assignment agreement must be put in place. The standard approach in the UAE is to have a three-party agreement or a fairly basic assignment agreement executed and notice then sent to the third party, requesting that a fairly detailed written acknowledgment accepting the terms and conditions of the assignment be returned addressed to the new beneficiary. The notice requirements will be subject to the terms of the underlying receivables contract.

An assignment implemented along these lines would give rise to a contractual obligation requiring the third party to fulfil his/her contractual obligations. In the event that the third party does not honour his/her agreement and pays the previous beneficiary rather than the assignee, the assignee should have a claim against the third party.

### 4.7 Identification

Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

Each receivable being sold should be documented with all available information pertaining to the relevant receivable. Needless to say, this will largely depend upon the nature of the receivables contract itself. For a sale to be effected, it must be possible to definitively determine the assets which are being sold.

### 4.8 Respect for Intent of Parties; Economic Effects on Sale

To the extent that the parties have denominated the transaction as a sale and clearly stated their intentions in the agreement, the only determination of the UAE court would be as to whether the contract adheres to local law requirements. If elements of the contract are unclear or the contract has not adhered to the requirements of the UAE, it is more likely that the economic characteristics of the transaction will be examined more closely.

In respect to the retention of control, this is not possible for the seller as, under the laws of the UAE, the sale must constitute a true sale and a divestment of the seller’s interest.

### 4.9 Continuous Sales of Receivables

Can the seller agree in an enforceable manner (at least prior to its insolvency) to continuous sales of receivables (i.e., sales of receivables as and when they arise)?

If the receivables which are subject to the sale are identifiable, both the receivables and the sale agreement itself are in existence at the time the sale is entered into and there are no existing prohibitions for the sale or assignment of those receivables, then a continuous sale of receivables should be possible.

### 4.10 Future Receivables

Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., "future flow" securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to or after the seller’s insolvency?

In the absence of express legislation in the UAE, there are differing schools of thought in relation to the sale of future receivables. One school of thought is of the opinion that the sale of future receivables is possible in circumstances where such receivables can be clearly identified. The other school of thought is that any sale of future receivables is not possible.

According to the second school of thought, the receivables which are to be sold, as well as the agreement creating the sale, must both be in existence at the time the sale is entered into. If the sale agreement has not yet been executed, or pertains to unidentifiable or non-existent receivables, the sale will not be valid under UAE law.

### 4.11 Related Security

Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?

Both the security and the receivables must pass concurrently, however it should be noted that this will depend on the nature of the underlying receivables. The transfer of any security relating to real estate must be
Security Issues

5.1 Back-up Security. Is it customary in the UAE to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

This will be transaction-specific and dependent upon the credit analysis of the transaction as well as the legal opinion, if or where relevant.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the UAE, and for such security interest to be perfected?

Under the Commercial Code, a commercial pledge can be granted over receivables. In order for a security interest to be perfected, it must pledge the receivables in a written document, with notice of the pledge provided to the underlying debtor.

Please see the answer to question 4.11 for the formalities in respect of the granting of security interests over related security in real estate, vehicles, vessels and aircraft.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the UAE to grant and perfect a security interest in purchased receivables governed by the laws of the UAE and the related security?

Please see the answer to question 5.2 above.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the UAE, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in the UAE or must additional steps be taken in the UAE?

If a security interest is governed by the laws of the UAE, then it must also be perfected and validated in line with the laws of the UAE in order to ensure that the courts view the security as being correctly perfected and enforceable.

Please refer to question 2.3 in relation to the interpretation of foreign law in the UAE.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

Please refer to the answers to: question 4.11 in respect of security interests generally; question 4.3 in respect of promissory notes; and question 5.2 in respect of real estate, vehicles, vessels and aircraft.

In respect of marketable debt securities, in order for a security interest to be validly created, a document pledging the specific securities has to be created, executed and delivered to the pledgee.

5.6 Trusts. Does the UAE recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

The UAE does not recognise common law trusts and the concept of a security trustee, as such, does not exist in the UAE. Under the Shari’ah however, the concept of an “adl” (a trustee-arbitrator) or agency does exist, and there is some overlap between the concept of a “security trustee” and that of an “adl”.

In light of the above, an “adl” can be used as a security agent in certain Shari’ah-compliant structured transactions in the UAE rather than using a security trustee.

5.7 Bank Accounts. Does the UAE recognise escrow accounts? Can security be taken over a bank account located in the UAE? If so, what is the typical method? Would courts in the UAE recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the UAE?

In the UAE, the concept of a floating charge is not recognised. There is also non-binding case law which states that if a pledge is made over funds in a bank account, these funds must not fluctuate and must remain at a fixed amount. To the extent that the amounts in the account fluctuate, this will cancel the validity of the pledge. Fixed charges do exist and so a pledge over funds in a bank account can be granted but only to the account-holding bank. It is for this reason, that those who are not resident but seeking a pledge over funds contained in an account normally appoint a UAE-based security agent to hold the security on their behalf.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

Subject to the answer to question 5.7 above, the secured party is able to take full control over Bank Accounts subject to a fixed charge.

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

No. Circumstances permitting enforcement should be triggered prior to affecting security.
6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the UAE’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If, after the sale of receivables, the seller becomes subject to insolvency proceedings, the transaction can be set aside by the insolvency official if the transaction was deemed to have been entered into by the seller during the suspect period. The suspect period will run from the suspension of payments date until the declaration of the seller’s bankruptcy.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

Please see the answer to question 6.1 above.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the UAE for (a) transactions between related parties and (b) transactions between related parties?

There is no defined length of the “suspect” or “preference” periods in the UAE whether it is between related or unrelated parties.

If there is no obvious date from which payments became suspended, the court will determine the “suspect” or “preference” periods on the basis of the date of the court’s judgment, the date of death, the date of loss of legal capacity, the date of closure of the relevant business or the date following 10 days after the list of verified debts is presented to the court clerk’s office.

A “suspect” or “preference” period cannot be longer than two years.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Insolvency proceedings are not yet well developed in the UAE and so remain indeterminable in respect of substantive consolidation.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in the UAE, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only come into existence after the commencement of such proceedings?

Insolvency proceedings are not yet well developed in the UAE and so remain indeterminable in respect of future receivables.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the UAE establishing a legal framework for securitisation transactions? If so, what are the basics?

The securitisations market in the UAE is in its very early stages, as a result of this, most securitisations are facilitated via the DIFC. The applicable DIFC laws to safeguard security and the securitisation structure would be the Law of Security (DIFC Law 8 of 2005, as amended), the Real Property Law (DIFC Law 4 of 2007), which specifically covers mortgages over land, and the DIFC Security Regulations.

7.2 Securitisation Entities. Does the UAE have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Traditionally this would not be facilitated in the UAE but rather through the DIFC which has offshore capacity. In the DIFC, special purpose companies can be easily established and benefit from the DIFC’s security enforcement regime and court system.

7.3 Non-Recourse Clause. Will a court in the UAE give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

In the absence of a common law equivalent of precedents, it is impossible to determine the court’s interpretation of a non-recourse clause in the UAE.

7.4 Non-Petition Clause. Will a court in the UAE give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

In the absence of a common law equivalent of precedents, it is impossible to determine the court’s interpretation of a non-petition clause in the UAE.
7.5 Priority of Payments “Waterfall”. Will a court in the UAE give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

As long as the decision of the jurisdiction and governing law are enforceable in the UAE, the UAE courts will allow enforcement.

7.6 Independent Director. Will a court in the UAE give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Subject to the general corporate rules and provided neither the articles nor memorandum of association contravene UAE law, this may be given effect.

8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the UAE, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the UAE? Does the answer to the preceding question change if the purchaser does business with other sellers in the UAE?

The usual formalities of establishing a company in the UAE will need to be adhered to.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

The usual formalities of establishing a company in the UAE will need to be adhered to.

8.3 Data Protection. Does the UAE have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

There are no data protection laws in the UAE restricting the use or dissemination of data by obligors.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the UAE? Briefly, what is required?

The Consumer Code of Rights was issued under UAE Federal Law (24) 2006 by the Ministry of Economy and sets out a list of sellers’ responsibilities, such as avoiding misleading advertising, providing consumers with accurate information about goods and services and service quality with due care.

8.5 Currency Restrictions. Does the UAE have laws restricting the exchange of the UAE’s currency for other currencies or the making of payments in the UAE's currency to persons outside the country?

There are no currency restrictions in the UAE restricting the exchange of currency for other currencies.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the UAE? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments by a company or individual from a source in the UAE to a non-resident of the UAE are subject to withholding tax.

9.2 Seller Tax Accounting. Does the UAE require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

All accounting matters in the UAE are in accordance with GAAP principles. All companies in the UAE are required to comply with GAAP standards.

9.3 Stamp Duty, etc. Does the UAE impose stamp duty or other documentary taxes on sales of receivables?

There is no stamp duty in the UAE but if there is a sale of receivables, payments by a company or individual from a source in the UAE to a non-resident of the UAE will be subject to withholding tax.

9.4 Value Added Taxes. Does the UAE impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

There are no value added taxes in the UAE.

9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

There are no value added taxes or stamp duties in the UAE.

9.6 Doing Business. Assuming that the purchaser conducts no other business in the UAE, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the UAE?

There are no taxes in the UAE.
Mr. Kanji is a leading debt capital markets practitioner with extensive experience in securitisation, sukuk and conventional debt capital markets. Ranked by Chambers Global 2010, 2011 and 2012, in which clients have said that he “consistently exceeds expectations” and “is a big name in Debt Capital Markets”. In both the United Kingdom and the Middle East, Mr. Kanji has advised a variety of global investment banks, sovereign states and multinational regional corporations.
1 Receivables Contracts

1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller, (a) it is necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a receivable “contract” be deemed to exist as a result of the behaviour of the parties?

With respect to a contract for the sale of goods for $500 or more, some writing sufficient to indicate that a contract for sale has been made is required. A contract for services is generally required to be in writing if, by its terms, it is not to be completed within one year. However, with respect to contracts for sales of goods, a formal sales contract is not required but rather a contract may be on the basis of exchanged purchase orders, general terms, and invoices, or by a combination of writings which are themselves insufficient to establish a contract coupled with the conduct by both parties which recognises the existence of a contract.

1.2 Consumer Protections. Do the USA’s laws (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?

(a) Each state has different limitations on the permissible rate of interest; however, U.S. federal law permits banks and some other depository institutions to use a uniform nationwide rate, determined by the law of the state where the principal office of the institution is located.

(b) Not to our knowledge.

(c) Certain jurisdictions provide consumers with a period of time to cancel certain types of transactions after entering into a contract, in some cases these rights only apply when the contract was entered into in a specified context (e.g., when a contract is entered into with a merchant other than at a merchant’s regular place of business).

(d) Consumers benefit from a number of protections. For example, restrictions on assignment of consumer loans are generally enforceable. In addition, personally-identifiable consumer information cannot be disclosed or used other than in specified manners.

Federal and state consumer protection laws and regulations regulate the relationships among credit card members, credit card issuers and sellers of merchandise and services in transactions financed by the extension of credit under credit accounts. These laws and regulations include the Credit Card Accountability and Disclosure Act, the Federal Truth-in-Lending Act and Fair Credit Billing Act, and the provisions of the Federal Reserve Board’s Regulation Z issued under each of them, the Equal Credit Opportunity Act and the provisions of the Federal Reserve Board’s Regulation B issued under it, the Fair Credit Reporting Act and the Fair Debt Collection Practices Act. These statutes and regulations require credit disclosures on credit card applications and solicitations, on an initial disclosure statement required to be provided when a credit card account is first opened, and with each monthly billing statement. They also prohibit certain discriminatory practices in extending credit, impose certain limitations on the charges that may be imposed and regulate collection practices. In addition, these laws and regulations entitle card members to have payments and credits promptly applied on credit accounts and to require billing errors to be promptly resolved. The Credit Card Accountability and Disclosure Act and the provisions of the regulations that implemented it, limit the ability of credit card issuers to increase the interest rates on existing credit card balances, regulate how interest is calculated for each billing cycle, and regulate how payments must be allocated to outstanding balances with different interest rates. A card member may be entitled to assert violations of certain of these consumer protection laws and, in certain cases, claims against the lender or seller, by way of set-off against his or her obligation to pay amounts owing on his account. For example, under the Federal Truth-in-Lending Act, a credit card issuer is subject to all claims, other than tort claims, and all defences arising out of transactions in which a credit card is used to purchase merchandise or services, if certain conditions are met. These conditions include requirements that the card member make a good faith attempt to obtain satisfactory resolution of the dispute from the person honouring the credit card and meet certain jurisdictional requirements. These jurisdictional requirements do not apply where the seller of the goods
or services is the same party as the card issuer, or controls or is controlled by the card issuer directly or indirectly. These laws also provide that in certain cases a card member’s liability may not exceed $50 with respect to charges to the credit card account that resulted from unauthorised use of the credit card. In addition, the Dodd-Frank Act became federal law in 2010 and contains numerous regulations relating to the financial industry and provides for the establishment of the Bureau of Consumer Financial Protection. It is not yet clear how implantation of the Dodd-Frank Act will affect consumer receivables.

The Servicemembers Civil Relief Act allows individuals on active duty in the military to cap the interest rate and fees on debts incurred before the call to active duty at six percent. In addition, subject to judicial discretion, any action or court proceeding in which an individual in military service is involved may be stayed if the individual’s rights would be prejudiced by denial of such a stay. Currently, some account-holders with outstanding balances have been placed on active duty in the military, and more may be placed on active duty in the future.

1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?

Yes, if the debtor is the U.S. government or one of its agencies or instrumentalities. In such a case the Federal Assignment of Claims Act will apply to an assignment of receivables and the right of the federal government to exercise set-off. A minority of states have similar laws that apply to obligations of the state or agencies or departments thereof and a few states extend such rules to municipalities and other local governmental entities.

2 Choice of Law - Receivables Contracts

2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in the USA that will determine the governing law of the contract?

Courts generally apply the choice of law rules of the state in which the court is located, and thus answers to choice of law questions may differ depending on the state in which the litigation is prosecuted. Under the Restatement 2nd of Conflicts of Law, the rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties. In the absence of an effective choice of law by the parties, the contacts to be taken into account in determining the law applicable to an issue include: (a) the place of contracting; (b) the place of negotiation of the contract; (c) the place of performance; (d) the location of the subject matter of the contract; and (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

2.2 Base Case. If the seller and the obligor are both resident in the USA, and the transactions giving rise to the receivables and the payment of the receivables take place in the USA, and the seller and the obligor choose the law of the USA to govern the receivables contract, is there any reason why a court in the USA would not give effect to their choice of law?

The U.S. is a multi-jurisdictional country and the contract needs to select the law of a particular U.S. state (rather than federal law) as the governing law. The choice of the law of a particular state of the United States to govern a contract may not be given effect if it does not bear a reasonable relationship with the transaction or parties. A few states, such as New York, permit the choice of their law to govern a contract even in the absence of any contacts if the contract satisfies certain dollar thresholds; however another U.S. state may not respect this choice of law if litigated in the other U.S. state in the absence of a reasonable relationship. Of course, on the facts specified above, there is no reason that an effective choice of a US state law cannot be made.

2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in the USA but the obligor is not, or if the obligor is resident in the USA but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in the USA give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?

In general, the choice of law of the parties will be given effect in the circumstances described above. However, each state has somewhat different considerations in determining whether to give effect to a choice of non-U.S. law. Typically such a choice of non-U.S. law will be given effect if: (i) the chosen law has a reasonable and substantial relationship and sufficient contacts with the contract or the transaction contemplated thereby; (ii) the chosen law does not violate or contravene, nor is contrary or offensive to, a public or fundamental policy of the U.S. state determining such issue; and (iii) the chosen law was not induced or procured by fraud. Under the Restatement 2nd of Conflicts of Law, a court may decline to apply the law of a jurisdiction chosen by the parties to a contract (which may be another U.S. state or a foreign jurisdiction) when (1) it is necessary to protect the fundamental policies of the state, the law of which would otherwise apply, and (2) such state has a materially greater interest in the determination of a particular issue than the state of the chosen law. It is not possible to make a definitive statement of when the fundamental policy exception would apply since each U.S. state and each court will reach its own determinations on a case-by-case basis.


Yes, it is.

3 Choice of Law - Receivables Purchase Agreement

3.1 Base Case. Does the USA’s law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., the USA’s laws or foreign laws)?

Generally, there is no reason that the law of the state governing the contract giving rise to the receivables needs to be the same as the law of the state governing the sale of the receivables. However, as noted below in response to question 3.4, the sale of the receivables will need to be perfected under the Uniform Commercial Code and the law governing perfection cannot be selected by the parties but, instead, is subject to mandatory choice of law rules.
that are organised under the laws of any state of the United States, their “location” for purposes of the UCC (and hence the law governing perfection by filing) will be their state of incorporation.

Where perfection is obtained by possession of the original promissory note or tangible “chattel paper” evidencing the receivable, the law of the jurisdiction where the promissory note or tangible chattel paper is physically located will govern perfection of a possessory security interest. Examples of chattel paper include leases of office equipment; retail auto leases; and many retail instalment sales contracts.

3.5 Example 4: If (a) the obligor is located in the USA but the seller is located in another country, (b) the receivable is governed by the law of the seller’s country, (c) the seller and the purchaser choose the law of the seller’s country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller’s country, will a court in the USA recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the USA’s own sale requirements?

Generally yes.

3.6 Example 5: If (a) the seller is located in the USA, (irrespective of the obligor’s location), (b) the receivable is governed by the law of the USA, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser’s country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser’s country, will a court in the USA recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with the USA’s own sale requirements?

The answer to this question will generally be the same as the answer to question 3.4 above.

4 Asset Sales

4.1 Sale Methods Generally. In the USA what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology - is it called a sale, transfer, assignment or something else?

Sales of receivables in securitisation transactions are generally structured as outright sales of all of the seller’s right, title and interest in, to and under the receivables and the related assets, and all proceeds of the foregoing. The transfer is valid and enforceable if the purchaser gives value, the seller owns, or has the power to sell, the accounts receivable and the sale is evidenced by an otherwise binding and enforceable contract. However, whether the transfer will be respected as a “true sale” or re-characterised as a security interest will depend on a number of factors discussed below in question 4.7. Sale terminology is customarily used to refer to these transactions, although governing documents will often use a combination of terms as a precaution.
4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

For sales of types of receivables not covered by the answer to question 4.3, the sale is perfected by filing of a UCC financing statement that identifies the seller, the purchaser and the receivables being sold. The financing statement must be filed in the appropriate filing office of the jurisdiction in which the seller is “located” – determined as provided in the answer to question 3.4.

4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Receivables evidenced by promissory notes or negotiable instrument, or that constitute “payment intangibles”, “chattel paper”, or “marketable securities”, all have different perfection rules.

Promissory Notes

A sale of “promissory notes” (most residential and commercial mortgage loans are evidenced by promissory notes) is automatically perfected, and no UCC financing statement needs to be filed, or other action needs to be taken, to perfect the sale. However, automatic perfection would not be applicable in the event that the sale was re-characterised as a security interest rather than a true sale and, accordingly, to protect against this risk, it is customary for a buyer to either take possession of the promissory notes or file a UCC financing statement to ensure that the buyer is perfected in the event of such a re-characterisation. In addition, if the purchaser fails to take possession of promissory notes it may be possible for another party who takes possession to obtain superior rights in the promissory notes. In the United States, most mortgage loans are evidenced by promissory notes.

Payment Intangibles

Mortgage loans that are not evidenced by promissory notes or other instruments are classified under the UCC as “payment intangibles” and are also automatically perfected. Again, it is customary to perfect by filing of a financing statement to protect against the risk of re-characterisation of the sale as a security interest rather than a true sale. A “payment intangible” is a type of “general intangible” under the UCC, and perfection of security interests in other types of general intangibles can be perfected only by filing a UCC financing statement.

Chattel Paper

In contrast to promissory notes and payment intangibles, a sale of chattel paper must be perfected regardless of whether it is characterised as a sale or a more traditional security interest. A sale of “tangible” chattel paper (i.e., evidence by traditional, hard copy writing) may be perfected either by filing a UCC financing statement or by the purchaser (or its agent) taking possession of the chattel paper. A sale of “electronic” chattel paper may be perfected either by filing a UCC financing statement or by the purchaser taking control of the chattel paper. In the case of conflicting security interests, a purchaser that gives new value and takes possession (or control in the case of electronic chattel paper) of the chattel paper in good faith, in the ordinary course of the purchaser’s business, and without knowledge that doing so violates the rights of another party, will have priority over a purchaser that perfects by filing.

Marketable Debt Securities

Sales of marketable debt securities are governed by Article 8 of the UCC rather than as a “secured transaction” under Article 9 of the UCC. A purchaser that gives value and obtains “control” of the securities, without notice of any adverse claim is a “protected purchaser” of the securities. A protected purchaser’s ownership interest will be free from attack by any other person claiming a security interest or other property interest in the securities. The necessary steps to achieving “control” over marketable debt securities involve (a) in the case of certificated securities, taking possession of such securities together with a written assignment executed by the seller, (b) in the case of uncertificated securities, either (i) having the securities transferred on the books and records of the issuer into the name of the purchaser, or (ii) having the issuer agree that it will follow the purchaser’s instructions regarding disposition or redemption of the securities being sold without the further consent of the seller, and (c) in the case of securities maintained in a securities account, either (i) having the securities transferred and credited to the purchaser’s own securities account, or (ii) having a securities intermediary that maintains the securities account to which the securities are credited, agree that it will follow the purchaser’s instructions regarding disposition or redemption of the securities being sold without the further consent of the seller.

4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Does the answer to this question vary if (a) the receivables contract does not prohibit assignment but does not expressly permit assignment; or (b) the receivables contract expressly prohibits assignment? Whether or not notice is required to perfect a sale, are there any benefits to giving notice - such as cutting off obligor set-off rights and other obligor defences?

Obligor notification is not required in order for a sale of the sellers’ rights in respect of the receivable to be effective as between the seller and the purchaser. However, the general rule under the UCC is that only once the obligor receives notice that the receivable has been sold: (i) can the purchaser enforce the payment obligation directly against the obligor; and (ii) must the obligor pay the purchaser in order to be relieved of its payment obligation. In addition, notifying the underlying obligor of the assignment has the advantage of preventing such obligor from exercising against the purchaser a right of set-off or defence that the obligor might have had against the seller and that accrues after the obligor receives notice of the assignment (although an obligor always retains the right of recoupment arising from the transaction that gave rise to the receivable) and, in those cases where the receivable has been fully earned by performance, prevents any amendment to the receivables contract without the consent of the purchaser. If, alternatively, the receivables are evidenced by a “negotiable instrument”, a purchaser who becomes a holder in due course may enforce directly against the obligor and takes free and clear of defences arising from the seller’s conduct, subject to a few exceptions under consumer protection laws. Similar rights are available to protected purchasers of debt securities.

Generally, a seller or obligor insolvency will not limit the ability of the purchaser of receivables to give notice to the obligors of the assignment of those receivables. The purpose of the notification requirement is to avoid the obligor being required to pay twice.
Unless the contract expressly requires such consent, obligor consent is generally not required under U.S. common law in order for a sale of the sellers’ rights in respect of the receivable to be effective as between the seller and the purchaser. The answer to the question of whether the language of the receivables contract changes the general rule depends upon the type of receivables involved. Generally, under the UCC, a provision in a non-consumer account receivable and certain other types of receivable which prohibits or restricts its sale, or which provides that a sale may give rise to a default, breach, right of recoupment, claim, defence, termination or remedy, is ineffective. However, the UCC provides that if a receivable containing such a prohibition is evidenced by a “promissory note” or is classified under the UCC as a “payment intangible”, although the sale is effective as between the purchaser and the seller the purchaser cannot enforce the receivable against the obligor and the sale does not impose any duty or obligation on the obligor.

4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective - for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings against the obligor or the seller have commenced? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

As noted in the response to question 4.4 above, notice to the obligor is required only to the extent of imposing certain obligations on the obligor. There is no specific form specified for delivery of notice other than that the notice must be an “authenticated record”, i.e., in a signed writing or the electronic equivalent thereof. Generally, there is no time limit for the delivery of such a notice, though, as noted above, there are advantages in giving the notice sooner rather than later and a seller or obligor insolvency should not limit the ability of the purchaser of receivables to give notice to the obligors of the assignment of those receivables, so long as the assignment was fully consummated before the commencement of the insolvency proceeding. The purpose of the notification requirement is to avoid the obligor being required to pay twice. A notice to an obligor need not be limited to a specific set of receivables and can cover future receivables as long as those receivables are identifiable.

4.6 Restrictions on Assignment; Liability to Obligor. Are restrictions in receivables contracts prohibiting sale or assignment generally enforceable in the USA? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If the USA recognises prohibitions on sale or assignment and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or on any other basis?

Generally, such restrictions will not be effective to prevent the granting of the security interest, though, as noted in the answer to question 4.4, in some cases such security interest will be unenforceable against the underlying obligor.

4.7 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?

No, the sale document need not specifically identify each receivable to be sold, but it must nonetheless provide a means for identifying objectively receivables that have been sold. Under the UCC, a security interest can be created in a broad category of assets (such as accounts receivable). If all receivables have been sold, no further identification should be required.

If all receivables have been sold other than receivables owing by one or more specifically identified obligors, a description of collateral referencing all receivables other than certain clearly identified excluded receivables can be an adequate description of collateral.

4.8 Respect for Intent of Parties; Economic Effects on Sale. If the parties denominate their transaction as a sale and state their intent that it be a sale will this automatically be respected or will a court enquire into the economic characteristics of the transaction? If the latter, what economic characteristics of a sale, if any, might prevent the sale from being perfected? Among other things, to what extent may the seller retain (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; or (d) a right of repurchase/redemption without jeopardising perfection?

Whether a receivables transfer will be recognised as a “true sale” (and not as a secured loan), in most states it is determined by judge-made common law. As a result, judicial authority analysing transfers as true sales is not always consistent. Several courts have given presumptive weight to the intent of the parties. Other courts, seeking the “true nature” of a transaction, have regarded the parties’ intent as only one attribute of a transaction and have balanced those attributes of a transaction indicative of a secured loan against those attributes indicative of a sale in order to determine whether the transaction more closely resembles a sale or a secured loan. Where commercially-sophisticated parties have characterised transactions as sales, and acted consistently with that characterisation, courts have generally been unwilling to disturb that characterisation even though the transactions may also bear certain attributes of secured loans. Upon a showing by “clear and convincing evidence”, however, that the transaction had the economic substance of a “disguised financing”, courts may invoke their equitable power to re-characterise the transaction accordingly.

Generally, a key element to finding that a sale took place, as opposed to a loan, is that recourse to the seller is limited or non-existent. Recourse to the seller can take several forms. Recourse for the uncollectibility of the receivables and recourse to provide a contracted rate of return are often cited in cases re-characterising transactions as loans. While not necessarily dispositive, a right of repurchase may adversely affect the characterisation of the transaction as a true sale.
5 Security Issues

5.1 Back-up Security. Is it customary in the USA to take a “back-up” security interest over the seller’s ownership interest in the receivables and the related security, in the event that the sale is deemed by a court not to have been perfected?

Yes, it is customary.

5.2 Seller Security. If so, what are the formalities for the seller granting a security interest in receivables and related security under the laws of the USA, and for such security interest to be perfected?

As described in the answers to questions 4.2 and 4.3, the grant of a security interest in a receivable is generally perfected by the filing of a UCC financing statement. For instruments and chattel paper, possession of the original is also available as a method of perfection.

5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in the USA to grant and perfect a security interest in purchased receivables governed by the laws of the USA and the related security?

The purchaser would be required to comply with the same formalities as did the seller, as provided in the answers to questions 4.2 and 4.3, although different locations of the purchaser and seller may result in the laws of a different jurisdiction being applicable to questions of perfection. Generally, if the relevant security agreement permits the filing of an “all assets” financing statement and the purchaser has appropriately filed such a statement, no additional UCC filing will be required in order for the providers of such purchaser’s funding to have a security interest in such receivables.

5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of the USA, and that security interest is valid and perfected under the laws of the purchaser’s country, will it be treated as valid and perfected in the USA or must additional steps be taken in the USA?

Generally, yes.

5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

See the answer to question 4.3.

5.6 Trusts. Does the USA recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller’s own assets until turned over to the purchaser?

Yes, trusts of various forms are generally recognised in United States jurisdictions; however, if the transaction is classified as a security interest under the UCC (as discussed above, this includes the purchase of most receivables) then simply having the seller agree to hold the assets in trust for the purchaser will not be sufficient to avoid the perfection and other requirements of the UCC.

5.7 Bank Accounts. Does the USA recognise escrow accounts? Can security be taken over a bank account located in the USA? If so, what is the typical method? Would courts in the USA recognise a foreign-law grant of security (for example, an English law debenture) taken over a bank account located in the USA?

Generally, jurisdictions in the United States will recognise escrow accounts, although the specific elements required for an escrow account and the specific legal status of an escrow account will vary by state. Generally, security can be taken over a deposit account in United States jurisdictions. Typically this is accomplished through an account control agreement whereby the depositary bank, the obligor and the secured party agree that the bank will follow the directions of the secured party rather than the account holder upon the occurrence of certain events. A court in the United States should...
recognise a foreign law grant of security taken over a bank account located in the United States as long as the form of security and perfection satisfied the requirement of control under the UCC, notwithstanding the law governing the instrument of control, subject to the choice of law, consideration addressed by the answers to the questions in section 2.

5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?

A secured party with control over a deposit account would have control over all funds thereafter credited to the deposit account; however, any bankruptcy filing by the grantor of the security interest would cut-off the secured party’s security interest as to funds credited to the account after the bankruptcy filing or within 90 days prior to the filing (one year if the secured party is an insider of the grantor).

5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?

Yes, the owner could have such access.

6 Insolvency Laws

6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will the USA’s insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a “stay of action”)? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?

If the sale of receivables was a true sale that occurred prior to the commencement of the seller’s insolvency proceeding, then the receivables involved in such a sale would not constitute property of the seller’s bankruptcy estate. Accordingly, the automatic stay would prohibit actions by the purchaser to obtain possession of, or otherwise exercise control over, the receivables. The purchaser could file a motion with the bankruptcy court for relief from the automatic stay to allow it to collect or otherwise exercise control over the receivables. However, any party in interest in the insolvency proceeding could object to the motion, and the bankruptcy court could deny the motion.

6.2 Insolvency Official’s Powers. If there is no stay of action under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser’s exercise of rights (by means of injunction, stay order or other action)?

If the transaction was a true sale, then the insolvency official normally does not have the power to prohibit the purchaser from exercising its rights as to the receivables purchased. However, the insolvency official conceivably could still request that the bankruptcy court issue an injunction or stay order (particularly if there is a question about whether the transaction was a true sale or if there was an infirmity in the transaction), and the bankruptcy court would have discretion in determining whether or not to grant such a request. The bankruptcy court has some leeway to fashion equitable relief.

6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a “suspect” or “preference” period before the commencement of the insolvency proceeding? What are the lengths of the “suspect” or “preference” periods in the USA for (a) transactions between unrelated parties and (b) transactions between related parties?

The debtor-in-possession, bankruptcy trustee or other party with requisite standing can avoid a transaction that took place within two years before the commencement of the insolvency proceeding, if the transaction was a fraudulent transfer pursuant to section 548 of the Bankruptcy Code. The look-back period for fraudulent transfers is two years both for transactions between unrelated parties and for transactions between related parties and, as discussed below, the look-back period for “preferences” is generally 90 days. Under section 548, a transaction constitutes a fraudulent transfer if the debtor: (a) made a transfer or incurred an obligation with an actual intent to hinder, delay or defraud any entity to which the debtor was or became indebted; or (b) received less than a reasonably equivalent value in exchange for the transfer or obligation, and the debtor (i) was insolvent when the transfer was made or the obligation was incurred, or became insolvent as a result thereof, (ii) was engaged (or was about to engage) in a business or transaction for which any property remaining with the debtor was an unreasonably small capital, or (iii) intended to incur (or believed that it would incur) debts beyond its ability to pay as such debts matured. If a transaction is avoided as a fraudulent transfer, then a transferee that takes for value and in good faith would have a lien on, or may retain, any property the debtor transferred to it, but only to the extent that the transferee gave value to the debtor in exchange for the transfer.

Pursuant to section 544 of the Bankruptcy Code, the debtor-in-possession, bankruptcy trustee or other party with requisite standing can avoid a transaction under applicable non-bankruptcy law. For example, a transaction could be avoided under state fraudulent transfer law. Most state fraudulent transfer statutes are based on the Uniform Fraudulent Transfer Act, and others are based on the older Uniform Fraudulent Conveyance Act. These statutes contain
elements that are similar to those set forth in section 548 of the Bankruptcy Code, though the look-back period under state fraudulent transfer statutes generally is longer than that under section 548. For example, the statute of limitations under the Uniform Fraudulent Transfer Act is four years after the transfer was made.

If the transaction is deemed to be a secured loan by the special purpose vehicle to the originator, then the debtor-in-possession, bankruptcy trustee or other party with requisite standing can avoid transfers made by the debtor-originator in connection with the transaction as preferential transfers, pursuant to section 547 of the Bankruptcy Code. Preferential transfers are those made (a) to a creditor, (b) on account of an antecedent debt owed by the debtor before the transfer was made, (c) while the debtor was insolvent, and (d) that enable the creditor to receive more than it would have received in a chapter 7 (liquidation) case. Generally, only transfers made within 90 days before the commencement of the insolvency proceeding are subject to avoidance as preferential transfers. However, transfers made to a special purpose vehicle within one year before the commencement of the insolvency proceeding may be subject to avoidance, because such transfers may be deemed to have been made to an “insider” (i.e., a related party). Courts typically recognise payments to fully-secured creditors as not being preferential. Even if the plaintiff can establish all of the elements of a preference claim, there are a number of statutory affirmative defences available to creditors, including defences for transfers made in the ordinary course of business and transfers in which the creditors provided contemporaneous or subsequent new value to the debtor.

6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding?

Courts have the equitable power to order substantive consolidation under section 105(a) of the Bankruptcy Code. Substantive consolidation has the effect of consolidating the assets and liabilities of multiple legal entities and treating them as if the liabilities were owed by, and the assets held by, a single legal entity. Inter-company claims and guarantees by consolidated entities are disregarded. Substantive consolidation may be ordered with respect to related entities that are all the subject of an insolvency proceeding, and also may be ordered with respect to related entities where some are the subject of an insolvency proceeding and the others are not.

Courts in the United States do not apply a uniform standard in determining whether to order substantive consolidation. However, a number of influential courts have stated that substantive consolidation is an extraordinary remedy that typically is reserved for circumstances in which (a) creditors had dealt with the various legal entities as a single economic entity, and did not rely on their separate identity in extending credit, or (b) the affairs of the entities were so entangled that substantive consolidation would benefit creditors. Courts are more likely to order substantive consolidation when principal parties consent.

In the past, courts have relied on a consideration of the following factors (among others) to guide their analysis of whether the relationships between multiple legal entities are so obscured that they could not be disentangled:

(1) the presence or absence of consolidated financial statements;
(2) the unity of interests and ownership between various corporate entities;
(3) the existence of parent and inter-corporate guarantees on loans;
(4) the degree of difficulty in segregating and ascertaining individual assets and liabilities;
(5) the transfer of assets without observance of corporate formalities;
(6) the com mingling of assets and business functions; and
(7) the profitability of consolidation at a single physical location.

Recent court decisions have adopted an open-ended, equitable inquiry to determine whether to substantively consolidate multiple legal entities. These courts have focused on the need in insolvency proceedings to protect the pre-petition expectations of creditors. Both case law and policy considerations indicate that a court primarily should base its determination on whether or not substantive consolidation would be equitable to the respective creditors of the entities for which substantive consolidation is sought.

When a special purpose vehicle is used as part of a securitisation transaction, parties rely on the separate corporate existence of that special purpose vehicle. The special purpose vehicle should be monitored to ensure that (a) corporate formalities are observed, (b) the assets and liabilities of the special purpose vehicle can be readily distinguished from those of the originator, (c) the separate legal existence of the special purpose vehicle and the originator are disclosed to third parties, and (d) the special purpose vehicle is appropriately limited in its investments, indebtedness, business and ownership. If this is the case and the originator were to become a debtor in an insolvency proceeding, then it is unlikely that a court would order substantive consolidation of the originator and the special purpose vehicle if a party objects.

6.5 Effect of Proceedings on Future Receivables. If insolvency proceedings are commenced against the seller in USA, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings or (b) on sales of receivables that only came into existence after the commencement of such proceedings?

The commencement of an insolvency proceeding of the originator would create uncertainties as to sales of receivables that have not yet occurred and sales of receivables that have not yet come into existence.

First, many future flow securitisations are structured such that there is recourse back to the originator (which may take the form of a guarantee from the originator). The existence of such recourse could cause a court to conclude that the future flow securitisation was not a true sale, but rather a secured loan.

Second, the receivables generated after the commencement of the originator’s insolvency proceeding could be deemed to be included in the originator’s bankruptcy estate, thus triggering the automatic stay as to those receivables. In addition, receivables generated after the commencement of the originator’s insolvency proceeding generally would not be subject to a lien resulting from the security agreement entered into by the originator and the special purpose vehicle before the bankruptcy filing (unless such receivables are the proceeds, products, offspring or profits of assets acquired prior to the bankruptcy filing and subject to a security agreement).

Third, if the assets securitised are receivables that arise under an executory contract, there is a risk that in an insolvency proceeding involving a party to the contract, that party would “reject” the executory contract and no further receivables would be generated. The term “executory contract” is not defined in the Bankruptcy
Code, but numerous courts have described it as a contract under which the obligations of both the debtor and the non-debtor are so far unperformed that the failure of either party to complete performance would constitute a material breach that excuses the performance of the other party. A debtor’s decision to reject an executory contract is subject to bankruptcy court approval, and parties have an opportunity to object to a proposed rejection. However, bankruptcy courts generally will approve the rejection of executory contracts so long as the debtor demonstrates a valid business justification for its decision to reject. The rejection of an executory contract is treated as a court-authorised breach by the debtor, and gives rise only to an unsecured claim by the non-debtor party for damages.

7 Special Rules

7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in the USA establishing a legal framework for securitisation transactions? If so, what are the basics?

Not as such.

7.2 Securitisation Entities. Does the USA have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?

Not as such. Certain U.S. federal tax laws, investment company regulations and securities laws have some provisions that facilitate securitisation by providing special rules for special purpose entities that satisfy certain requirements. Most domestic securitisations in the United States use entities organised as corporations, limited liability companies or statutory trusts under the laws of Delaware. Trusts created under the laws of New York are also common. Some types of U.S. securitisations, such as CDOs, use entities domiciled in offshore jurisdictions such as the Cayman Islands.

7.3 Non-Recourse Clause. Will a court in the USA give effect to a contractual provision (even if the contract’s governing law is the law of another country) limiting the recourse of parties to available funds?

Courts in the United States typically will enforce non-recourse clauses and any carve-outs thereto. These courts will determine, based on the facts of each case, whether any of the carve-outs to the non-recourse clause apply in a particular situation. In interpreting the non-recourse provision and its carve-outs, courts will analyse their language in an attempt to determine the intent of the parties. Courts will enforce the agreement of the parties, giving the contract language its normal and usual meaning. If a court determines that a carve-out to the non-recourse clause applies in a particular case, then recourse may not be limited. Courts generally will give effect to a non-recourse provision in a contract where the governing law is that of another country, unless the enforcement of that provision would offend the public policy of the state in which the court convenes.

Under section 1111(b) of the Bankruptcy Code, however, the general rule is that a secured claim in a Chapter 11 case is treated as a recourse claim, whether or not it is non-recourse by agreement or applicable law. This section of the Bankruptcy Code converts non-recourse claims to recourse claims, but also permits classes of unsecured creditors to elect to waive their deficiency claims and have their entire allowed claims treated as secured claims. This provision does not apply if the property is to be sold.

7.4 Non-Petition Clause. Will a court in the USA give effect to a contractual provision (even if the contract’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?

“Covenants not to sue” typically are governed by state law, and courts will interpret them in accordance with the rules governing the construction of contracts. To be enforceable, a covenant not to sue should be supported by adequate consideration by the beneficiary of the covenant. Courts very rarely refuse to enforce covenants not to sue that are negotiated in business transactions. However, they will not enforce covenants not to sue that violate applicable law or public policy.

Courts typically will also enforce contractual provisions prohibiting parties from commencing an involuntary insolvency proceeding against a purchaser or another person. Like covenants not to sue, courts will interpret these provisions in accordance with the rules governing the construction of contracts, and they should be supported by adequate consideration. However, covenants preventing entities from filing voluntary bankruptcy petitions probably are unenforceable.

7.5 Priority of Payments “Waterfall”. Will a court in USA give effect to a contractual provision (even if the contract’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?

In general, sophisticated parties may allocate proceeds of collateral and other payments among themselves by contract. Whether a U.S. court would apply a foreign choice of law depends on a wide range of factors but in general such choice of law is likely to be upheld if the jurisdiction chosen has a substantial relationship to the transaction and the application of such foreign law is not contrary to any fundamental policy of the applicable U.S. jurisdiction.

7.6 Independent Director. Will a court in the USA give effect to a contractual provision (even if the contract’s governing law is the law of another country) or a provision in a party’s organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?

Independent directors are often found in U.S. securitisation transactions in order to limit the ability of the SPE to commence voluntary bankruptcy proceedings. However, an agreement by an entity not to file a voluntary bankruptcy petition may be unenforceable as against public policy. In fact, failure of a director to commence bankruptcy proceedings when he/she properly concludes that it would be in the best interest of the SPE to do so may constitute a breach of fiduciary duty.
8 Regulatory Issues

8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in the USA, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in the USA? Does the answer to the preceding question change if the purchaser does business with other sellers in the USA?

Receivables purchases generally do not subject a purchaser to licensing or other qualification requirements to do business in the United States, although there may be exceptions to this rule from state to state depending upon the type of receivable. Collection and enforcement activities are more likely to require an entity to obtain a licence and qualify to do business within a state especially in the case of consumer receivables.

8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?

No general servicing licence is required. However, a servicer or replacement servicer may require the same licences possessed by the originator operating company depending upon the type of receivables and the jurisdiction involved. In addition, a servicer may need to meet certain licensing and other requirements with respect to collection and enforcement activities in limited instances.

8.3 Data Protection. Does the USA have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?

Confidential consumer information cannot generally be disclosed to third parties and can only be used for the purposes for which such information was provided. Entities possessing consumer information are generally obligated to safeguard such information from unauthorised access and disclosure.

8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of the USA? Briefly, what is required?

Consumer protection laws exist at both the federal and state levels in the United States. A purchaser may be liable for the acts of the seller originating the receivable, as these liabilities are considered to pass to the holder of the receivable. In addition, a purchaser could be subject to debt collection laws, reporting laws and confidentiality laws, among other laws.

8.5 Currency Restrictions. Does the USA have laws restricting the exchange of the USA’s currency for other currencies or the making of payments in the USA’s currency to persons outside the country?

Federal anti-money laundering laws require financial institutions to implement due diligence procedures with respect to their customers in order to prevent the transfer of cash to certain prohibited persons.

9 Taxation

9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in the USA? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located?

Payments of interest to the seller or the purchaser by debtors who are United States persons on interest-bearing debt obligations with maturities in excess of 183 days generally are subject to United States withholding tax if the seller or the purchaser is a non-resident of the United States. The statutory rate of United States withholding tax generally is 30 percent, but this rate is often reduced to zero percent by an applicable income tax convention between the United States and the seller’s or purchaser’s country of residence. In addition, certain payments of interest are exempt from withholding tax under the “portfolio interest” exception to withholding but most receivables are not in the registered form necessary to meet this exception. Payments of interest by United States-resident debtors to the seller or the purchaser may also be subject to “backup withholding” if the seller or the purchaser does not provide the payer with the appropriate certification that it is exempt from backup withholding. Backup withholding currently is imposed at a rate of 28 percent. It is not an additional tax but rather an advance payment of tax which may later be credited or refunded.

Payments of interest to the seller or the purchaser by debtors who are not United States persons are not generally subject to United States withholding tax unless such interest arises from a branch in the United States maintained by such debtor.

9.2 Seller Tax Accounting. Does the USA require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?

Most taxpayers are required to use the accrual method of accounting. In certain limited cases, some securitisation vehicles may elect to mark their assets to market.

9.3 Stamp Duty, etc. Does the USA impose stamp duty or other documentary taxes on sales of receivables?

There are no federal stamp duties or documentary taxes on sales of receivables, and these types of charges are unusual at the state level.

9.4 Value Added Taxes. Does the USA impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?

There are no federal value added taxes or sales taxes on sales of goods or services, on sales of receivables or on fees for collection agent services. Virtually all of the 50 states of the United States have some form of state sales tax on sales of goods or services. In general, no value added, sales or similar taxes will apply to sales of receivables or to fees for collection agent services.
9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?

As discussed above, there are no federal stamp duties or documentary taxes on sales of receivables. The ability of state taxing authorities to collect any value added tax, stamp duty or other taxes, if imposed, may vary.

9.6 Doing Business. Assuming that the purchaser conducts no other business in the USA, would the purchaser’s purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in the USA?

If a non-resident purchaser is considered to be carrying on a trade or business in the United States, it will be required to file a U.S. federal income tax return and, absent an applicable income tax convention between the United States and the country where the non-resident purchaser is resident, will be required to pay United States federal income tax on any income that is effectively connected with its carrying on of a trade or business in the United States (ECT). Typically, a purchaser resident in a country with which the United States has an income tax convention will only be subject to U.S. federal income tax on its ECT from a trade or business carried on through a permanent establishment in the United States.

Whether or not the purchaser is carrying on a business in the United States, or has a permanent establishment in the United States, is a question of fact to be considered on a case-by-case basis. Particular attention must be given to the appointment of a seller resident in the United States as servicer and collection agent for a non-resident purchaser, in order that such appointment does not cause the purchaser to be considered to be carrying on a trade or business through a permanent establishment in the United States (thus giving rise to ECT).

Lawrence Safran leads the firm’s Uniform Commercial Code practice. This area includes a wide variety of commercial law issues. Special emphasis is placed on those issues arising under Article 9 (secured transactions) and Article 8 (investment securities) of the Uniform Commercial Code although the practice also includes Article 2 (sales of goods), Article 3 (negotiable instruments), Article 5 (letters of credit), Article 6 (bulk sales) and Article 7 (documents of title).

Mr. Safran has advised clients on commercial law and personal property transfer issues in connection with credit facilities, secured bond transactions, project financings, real estate securitisations, collateralised debt obligations, credit card and other receivables financings and other structured financing arrangements.

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Mr. Fingeret has extensive experience representing banks and other financial institutions, issuers, borrowers and sponsors in a wide variety of structured finance and securitisation transactions and aircraft finance transactions. Mr. Fingeret specialises in the securitisation of esoteric and operating assets. His experience includes aircraft portfolio securitisations, EETC aircraft financings and securitisations of rental car fleets, wireless cell towers (and related real property interests), broadcast towers, billboards, equipment leases and music royalties. Mr. Fingeret also has substantial experience with traditional ABS, such as auto loan and credit card securitisations and traditional aircraft finance, such as bank financings and sale-leaseback transactions involving aircraft, engines and spare parts.

Mr. Fingeret also has over fourteen years of experience representing issuers, underwriters and managers in CLO transactions.