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Transactions Law
Reform Project

DISCUSSION PAPER SERIES:

SALES OF RECEIVABLES

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SALES OF RECEIVABLES

1 Introduction

This paper considers whether, or to what extent, the proposed scheme for the registration and priority of charges should be extended to cover outright sales of receivables as well as charges over receivables.

One of the striking features of Article 9 of the Uniform Commercial Code and of the various Personal Property Security Acts is that the scheme of registration and priority applies also to outright sales of "accounts" (i.e. receivables), to the extent that where there have been two or more assignments of the receivables (whether by way of sale or charge), priority is normally determined by the date of registration of the assignment; and, in most of the schemes,¹ a sale of a receivable that has not been registered when the assignor becomes insolvent will not be effective as against the assignor's liquidator, etc.

This is very different to our current law, under which there is no requirement to register outright sales of a company's receivables, and priority is determined under what is known as the rule in *Dearle v Hall*.² A general assignment of book debts by an unincorporated business must be registered as a bill of sale to be effective in the assignor's bankruptcy.³ It appears that the rule in *Dearle v Hall* also applies to the question of the priority of competing general assignments.⁴

¹ The New Zealand Personal Property Act 1999 does not render ineffective security interests (whether in the form of a charge over any type of asset or of a sale of receivables) that have not been registered before the chargor's insolvency: see Law Com CP No 176, para 2.49.

² (1828) 3 Russ 1, 38 ER 475; see below, p. 3.

³ Insolvency Act 1986, s 344.

⁴ Although the priority of competing bills of sale is determined by the date of registration, Bills of Sale Act 1878 s 10, it is not thought that s 344 Insolvency Act 1986 has the effect of applying this rule to competing general assignments. s 344(4) provides that: "For the purposes of registration

Article 9 UCC and the PPSAs do not re-characterise outright sales of receivables as if they were security interests in every respect, in the way that they treat retention of title devices. Retention of title transactions are treated as no more than security for the price and finance charges owed by the debtor (i.e. the buyer or, in the case of a finance lease, the lessee), so that any surplus value in the collateral (i.e. the goods sold or leased to the debtor) is treated as the debtor's property. In contrast, when receivables are sold, the assignee (typically, a receivables financier) is entitled to collect and retain the full value of each receivable. An outright assignment thus remains a true sale, that is, a transfer of the entire interest of the assignor in the receivables.⁵ We are not aware that anyone has suggested that sales of receivables should be wholly re-characterised as security interests, and we see no case for doing so.

To us the critical questions relating to the outright sale of receivables by a company or by an unincorporated business are three: (a) should the sale be governed by the priority rules of the scheme? (b) Should the sale have to be perfected by registration in order to be effective in the assignor's insolvency? And (c) if the scheme is to apply, precisely which receivables should it apply to?

There is a "chicken and egg" problem over the order in which to consider the questions: it may not be easy to answer questions (a) and (b) until we know which receivables are to be covered. We think the best approach is to ask whether any extension of the scheme should apply at least to "bog standard" sales of receivables - i.e. bulk assignments, or assignment of batches, of sums due to the assignor for goods or services supplied, to a receivables financier. So this paper will consider questions (a) and (b) in relation to assignments of these types. It will then consider the precise definition of receivables and whether there would need to be any exceptions for particular kinds of assignment or particular types of receivable.

We will also assume that the Government will exercise its power to introduce an override of "bans on assignment" in contracts giving rise to receivables.⁶ This is a feature of the Article 9

under the Act of 1878 an assignment of book debts is to be treated as if it were a bill of sale given otherwise than by way of security for the payment of a sum of money; and the provisions of that Act with respect to the registration of bills of sale apply accordingly with such necessary modifications as may be made by rules under that Act." That does not address the question of priority..

⁵ This is why in the literature on Article 9 and the PPSAs, sales of receivables are sometimes referred to as "deemed security interests", whereas retention of title clauses are called "in substance security interests" (e.g. Law Com CP No 176, *passim*).

⁶ Small Business, Enterprise and Employment Act 2015, s 1.

/ PPSA schemes.⁷ It is not clear, however, that the existence or otherwise of such an override makes much difference to the issues to be discussed in this paper.⁸

There is also a problem of terminology. When they deal with outright sales of receivables, Article 9 and the PPSAs refer to the assignor as "the debtor" or "grantor" and the assignee as "a secured party", i.e. they use the same terminology as when receivables are charged. This can be confusing since (a) the assignor does not owe anything to the assignee, but rather has received funds from or has been given a line of credit by the assignee, in exchange for the receivable; (b) the only true debtor is the "account debtor" which owes the receivable; and (c) the assignee is not a secured party in the normal sense but a buyer of the receivable. For the purposes of this paper, in which we are discussing sales under receivables financing, we think it will be easier if normally we refer to the party to whom the receivable is originally payable as the Supplier, the party which owes the receivable as the Customer, and the assignee as the Receivables Financier.

2 The purposes of registration

The various reasons for requiring registration of charges were set out in our Registration paper. To summarise, the principal reasons are

1. to enable a party who is thinking of advancing credit against the security of the debtor's assets to discover whether those assets are already encumbered
2. to enable a creditor who does take security by safeguard its priority over earlier but unregistered, and subsequent, security interests;
3. to enable other parties such as actual or potential unsecured creditors and investors, to find out to what extent the debtor's apparent assets are in fact subject to security interests in favour of other creditors;
4. if the debtor becomes insolvent, to make it simpler for insolvency officer to determine which of the debtor's assets are subject to a security interest; and
5. to provide a more-or-less contemporaneous record of secured transactions, to avoid the debtor denying the transaction or the creditor backdating it.⁹

⁷ e.g. Australian PPSA s. 81; Ontario PPSA section 39, British Columbia PPSA section 41(9), Saskatchewan PPSA section 41(9); UCC §9-401(b), UCC §9-406(d) and UCC §9-408(a); UNCITRAL Model Law on Secured Transactions article 13(1) and (2); UN Convention on the Assignment of Receivables in International Trade article 9. The effect of these provisions on a ban on assignment (e.g whether it is rendered wholly ineffective, or the assignor remains liable in damages to the account debtor for any loss caused by a prohibited assignment) varies in ways that do not concern us here.

⁸ But see n 35 below.

⁹ A sixth reason, that the scheme can include asset-based registration, is not relevant to outright sales of receivables.

In general terms, those reasons apply equally to requiring registration of outright sales of receivables. So do the general arguments against registration: for example, the cost involved and the fact that transactions that previously could be entirely private may have to be disclosed publicly.

We will not repeat the general discussion here. Suffice it to say that we envisage that any extension of the scheme to outright sales of receivables would use the same scheme of simple and low-cost, on-line registration, etc, that we envisage for registering charges.

In essence, reasons 1 and 2 in the list go to issues of priority and reasons 3-5 to registration for the purposes of perfection. We will consider priority first and then registration for perfection, before turning to the precise definition of receivable and any exceptions that would be needed.

3 **Priority**

When receivables are charged or sold, the priority of the competing assignments¹⁰ is determined by the order in which notice was given to the customer unless, at the time the second receivables financier took its assignment, it had actual or constructive notice of the earlier assignment.¹¹ Registration of a charge created by a company over its receivables will put any party dealing with the supplier on constructive notice of the first assignment, if they can reasonably be expected to search the register. Although there is no firm authority on the point, it is thought that receivables financiers are among those expected to search, whether they are contemplating taking a charge or an outright assignment.¹²

3.A DISCOVERING A PREVIOUS ASSIGNMENT

This means that the primary way for a receivables financier to find out whether the Supplier's receivables have already been charged or assigned, other than by relying on the debtor's word or its accounts, is to ask the Customer.

It is true that to a limited extent the Receivables Financier will be assisted by the existing schemes of registration. If the supplier is a company and the first assignment was by way of charge, the charge should be registered within 21 days of its creation; and a "second chargee" which, after the 21 days, searches the register and itself takes and registers a charge, will have priority over the earlier charge, even if subsequently the first chargee is permitted to register

¹⁰ For the purposes of this paper, we will assume that a charge over receivables is a type of assignment.

¹¹ *Dearle v Hall* (1828) 3 Russ 1, 38 ER 475.

¹² E McKendrick (ed), *Goode on Commercial Law* (4th ed, 2010), 709. See the discussion in H Beale, M Bridge, L Gullifer and E Lomnicka, *The Law of Security and Title-based Finance* (2nd ed, 2012), para 14.13.

out of time. So the "second chargee" can be confident of having priority over any earlier charge if no earlier charge is registered within 21 days of the date of the initial search.

For a different reason, an outright purchaser of the receivables will normally be protected if it takes its assignment before the earlier charge was registered or notified to the Customer, and the purchaser promptly gives notice to the Customer. The purchaser will not have constructive notice of the earlier but unregistered charge and, unless it has actual knowledge of the charge, will take free of it under the rule in *Dearle v Hall*.

That leaves evident gaps in the system:

- (1) As between competing chargees, there is the problem of the 21-day invisibility period, discussed in our paper on *Priority*.
- (2) When the first interest is a charge and the second an outright purchase, but the later assignment is on a non-notification basis, the receivables financier may end up taking subject to the earlier charge whether or not the charge had been registered by the time of the second transaction.¹³
- (3) Probably much more serious is the fact that there is no scheme of registration of outright assignments by a company, only for general assignments by unincorporated businesses. Thus the only way in which a potential receivables financier can check whether a corporate supplier has already sold its receivables is by contacting the customers by whom the receivables are owed.

Nor is the situation much better with unincorporated suppliers. Although a general assignment of debts or a class of debts by an individual must be registered as a bill of sale, the register is paper-based and can only be searched by visiting the High Court. The Law Commission has reported that because of these difficulties

... most invoice financiers have other ways of verifying the book debts that the business offers for sale. For factoring agreements, the invoice financier telephones debtors to check whether the debt has already been assigned. For invoice discounting agreements, auditors investigate whether there has been any previous assignment to maintain confidentiality.¹⁴

Contacting the party who is due to pay a debt to find out whether the debt has already been assigned is feasible when only a small number of debts are involved. We have no wish to change the priority rule for assignment of debts in general; we are concerned only with receivables financing. Even in that context, contacting each Customer may be feasible if the supplier has only a small number of customers. But when the receivables come from significant number of sources contacting each customer is not practical.

¹³ The sanction for failing to register the charge within 21 days is that it is void against a "creditor of the company" (Companies Act 2006, s 859H(3)), which does not include an outright purchaser of the receivables.

¹⁴ Law Com CP No para 6.49; see also Law Com No 369, para 9.8(4).

As a result, a party thinking of advancing credit against or purchasing a supplier company's receivables may have either to carry out an extensive (and expensive) audit of the Supplier's accounts to determine whether there has been a previous sale, or take the Supplier's word for it that there have been no previous assignments of them. This may make receivables financiers reluctant to deal with suppliers that they do not know and trust, and so have an adverse effect on the supply of receivables financing.

3.B SAFEGUARDING THE RECEIVABLES FINANCIER'S OWN PRIORITY

The flaws in the system also mean that it can be hard for a Receivables Financier that buys receivables to safeguard its own position. The only way to ensure that priority is not lost to a subsequent assignment, or to an earlier outright assignment that has not yet been notified to the customer but of which notice is given subsequently, is for the Receivables Financier to give notice of the assignment to the Customer. This is not a problem if the arrangement between Supplier and Receivables Financier is a "factoring" agreement under which the Receivables Financier will notify the Customer and collect the receivable directly; but many Suppliers prefer to have a non-notification (often called "invoice discounting") arrangement, so that the Customer may not know of the assignment. The Supplier will collect the receivables on the Receivables Financier's behalf.

3.C PRIORITY BY DATE OF REGISTRATION

A system under which priority of both charges over and outright sales of receivables is by date of registration, as under all the schemes referred to earlier, would solve these problems. A potential Receivables Financier would be able check the register. If it found a registration, it would be warned that the receivables in question have been, or may have been,¹⁵ sold or charged already, and to whom. If it wishes to find out more it can then contact the chargee or buyer named in the registration. If it finds no record of earlier assignments of the receivables in question, and decides to buy them, it can secure first priority by registering.

3.C.i *Notice filing*

In our *Registration* paper discussing registration in general, we noted that it would probably be convenient to allow registration in advance of the actual transaction. The advance filing would constitute a priority point. We said that this could be combined with a requirement to indicate that an actual transaction has taken place within so many days¹⁶ (i.e. a 'priority notice' scheme), or it could be a 'notice filing' scheme. A notice filing scheme would allow a single registration (or filing) to cover a series of similar transactions between the same parties, but would not indicate what transactions, if any, had in fact been entered. In its

¹⁵ See next subsection.

¹⁶ STR, *Registration*, Part 7.

report on *Company Security Interests*¹⁷ the Law Commission recommended a notice filing scheme. This was because the Law Commission understood that at the time it was common to offer receivables to Receivables Financiers in blocks on a 'facilitative' basis, with each block being the subject of a separate sale. To avoid the Receivables Financier having to register, or alter the existing registration, repeatedly, it seemed sensible to allow a single registration to cover a series of sales. We understand that, at least with corporate suppliers, it is now more common for receivables financing of trade receivables to be carried out under a whole turnover agreement, under which all the Supplier's receivables (or all its receivables from a particular source) are the subject of a single assignment of present and future debts. Offers for sale are used only when the supplier is unincorporated and, naturally, with one-off sales of invoices through trading platforms.¹⁸ We do not see any reason of principle why whole turnover agreements could not be used with unincorporated suppliers, and the issue of advance filing does not arise with one-off sales. Therefore from the point of view of receivables financing there is perhaps less need for a 'notice filing' system, as opposed to a 'priority notice' scheme, than the Law Commission thought - though a general case for notice filing can still be made. We would welcome views on this issue.¹⁹

3.D POSSIBLE PROBLEMS

A number of objections have been raised to making the priority of outright sales of receivables depend on the date of registration.

3.D.i *The Customer may pay "the wrong person"*

In the responses to the Law Commission's Consultative Report, it was argued that if priority as between competing assignments depends on the order of registration and not the order in which notice is given to the Customer or other account debtor, the latter may not be given notice of the assignment that has priority but only of the second-ranking assignment, and thus may pay the "junior" assignee. This is true, but we do not think it is a serious problem. First, if there is a reliable system of registration of outright sales of receivables, most Receivables Financiers will file as a matter of course and so second sales of the same receivables will be rare. Secondly, as the Law Commission pointed out:

"... similar problems can arise under current law. Giving notice to the account debtor will not secure priority if at the time the second assignment was taken the second assignee had actual or constructive notice of the earlier assignment, yet the account debtor will be discharged by paying the first

¹⁷ Law Com No 292, 2005, para 3.88.

¹⁸ We are grateful to colleagues at ABFA for this information.

¹⁹ The advantages and disadvantages of permitting notice filing, as opposed to either transaction filing simpliciter or transaction filing combined with a priority notice scheme (as is currently available for security over land) were discussed in the Registration Paper: STR, *Registration*, Part 6.

assignee to notify it. The junior assignee will have to pay the proceeds over to the senior assignee. Similarly, where receivables have been assigned without notifying account debtors, account debtors will be discharged by paying the assignor, who must account to the assignee."²⁰

It would however be possible to lay down a set of rules to govern this issue, as in the UNCITRAL Model Law, but as it is both complex²¹ and a second-order issue, we will not consider it unless and until it has been decided to develop a scheme of priority by date of registration.

3.D.ii *Fear of publicity*

Some Suppliers are reluctant to let it be known that they are assigning their receivables. They may think the Customer who owes the debts assigned will be reluctant to do business with them if they are reliant on receivables financing, and so try to prevent the Customer from finding out by arranging the financing on a non-notification basis; and they may be worried about the effect on their other customers, unsecured creditors and their credit rating in general. Providing that registration of an outright assignment should constitute a priority point would encourage Receivables Financiers to register. Should Suppliers worry about the publicity and a possible loss of reputation as a consequence?

We think the answer is no, for three reasons. First, in practice, in most non-notification receivables financing, the Receivables Financier takes not just an equitable assignment but also a charge over the Supplier's receivables. This charge is registered at Companies House and so there is just as much publicity as there would be under the new scheme. Secondly, registration at Companies House or in a new Security Register is not the same as having to notify the Customer. Few Customers seem to search the Companies Register and then, if they find a Receivables Financier has registered a charge against the Supplier, refuse to do business with the Supplier. Thirdly, if the new scheme is limited to making priority depend on registration, and does not extend to registration for the purposes of perfection,²² a Receivables Financier who can be persuaded to trust the Supplier to have revealed any

²⁰ Law Com No 296, para 4.15.

²¹ Under the UNCITRAL Model law the rules vary depending on whether the double assignment is two assignments by the same creditor (A owed £100 to B who assigns the debt to C and then to D) or on whether the second assignment is by the second assignee (A owed £100 to B who assigns the debt to C, and C then assigns it to D). In the former case, the debtor is released by paying the last person who notifies and in the latter case the debtor is released by paying the first person. The difficulty the debtor might face in distinguishing between the two situations is 'solved' by a provision enabling a confused debtor to demand information from the notifying assignees.

²² See next section.

previous assignments and not to make any further assignments of the same receivables has no need to register.

3.D.iii *A combined system*

We should add that it has sometimes been suggested that priority of outright assignments should depend on the date of either registration or notification to the account debtor, whichever was first.²³ We do not regard such a system as workable: the register would cease to be a reliable record but the Customer would not necessarily have been notified, so the Receivables Financier would have to consult both the register and the Customer. That would defeat the purpose of the register.

3.E CONCLUSION ON PRIORITY

Our provisional conclusion is that there is a strong case for bringing outright sales of receivables (at least standard trade receivables²⁴) within the proposed scheme for the purposes of priority. This was also the conclusion of the Law Commission.²⁵

We note that this was also the recommendation in the recent review of the Australian PPSA.²⁶ Although the author of the Review is discussing inclusion of outright sales of receivables in the scheme generally, the discussion centres on registration for the purposes of priority, and it is worth quoting at length:

Is there a publicity concern ?

An account is intangible, and a transfer of an account is by necessity an invisible transaction. Unlike tangible property, a potential buyer cannot physically inspect an account to see whether the seller appears to be the owner. It could be argued for this reason that the Act should apply to transfers of accounts, in order to provide third parties with a mechanism that assists them to determine whether the owner of an account might have already transferred it.

Against this, however, it could be argued that a registration system that discloses the existence of a transfer of an account cannot give a searcher of the register a complete picture. This is because a potential purchaser of the account cannot use the register to determine whether the account exists in the

²³ See Scottish Law Commission, Discussion Paper on Moveable Transactions (Scot Law Com DP No 151, 2011), para 14.32

²⁴ See above, p 6 and section 4.C below.

²⁵ Law Com No 296, para 4.18.

²⁶ B Whittaker, *Review of the Personal Property Securities Act 2009, Final Report* (Commonwealth of Australia, 2015)

first place. And as the account is an intangible, the potential purchaser is unable to verify its existence by means of a physical inspection. The only way in which a potential purchaser of an account can determine whether or not the account exists, other than by relying on the transferor's word, is by making relevant enquiries of the putative obligor – as would be the case if the Act did not apply. And if the purchaser needs to rely on the transferor's word as comfort that the account exists, why should they not also rely on the transferor's word that the account is unencumbered? This suggests that a potential purchaser of an account does not gain as much comfort from a search of the Register as might initially be thought to be the case, and this might be thought to call into question the extent to which the Register really assists them.

Even though a search of the Register will not indicate whether an account that is the subject of a proposed transfer in fact exists, it does help a prospective purchaser to narrow the risk in its transaction, by enabling it to determine whether the transferor might have already transferred it, or have given security over it, to another person. So while the Register will not assist a searcher to determine whether a particular account does exist, I can see that perfection by registration on the Register can provide third parties with some potentially useful information.

Are there characterisation difficulties ?

A transfer of an account can take many forms. At one end of the spectrum, a transferor may transfer the benefit of an account to a transferee on the basis that the transferee takes on all the risks associated with the account, including whether and when the obligor on the account will pay. At the other end of the spectrum, a transferor could agree with the transferee that the transferee can sell the account back to the transferor, or that the transferor will otherwise indemnify the transferee, if the account is not paid on time and in full. There are also many variations in between, under which a transferor may agree that the transferee can have recourse back to the transferor for certain types of risks, but not others.

A transfer of an account with no recourse is unlikely to be a security interest on general principles, whereas a sale with full recourse almost certainly would be. It may be very difficult, however, to decide whether a transaction that falls between these extremes will or will not give rise to an in-substance security interest. Parties are relieved of the need to make potentially difficult decisions as to the proper characterisation of their transaction if all transfers of an account are captured by the Act, whether or not they have a security function.

Is it a similar financing arrangement to an in-substance security interest ?

Businesses often sell their trade receivables or book debts as a tool to finance their working capital, whether the sale is structured as a security transaction or as a non-recourse sale. If it is appropriate to extend the reach of the Act to

transactions that serve a similar purpose to a security transaction, then it may be appropriate to include transfers of accounts in the Act, at least to the extent that the accounts are of this type.

Does the Act provide better rules ?

Finally, it can be argued that the Act provides a simpler and clearer set of rules to govern transfers of accounts than the general law rules that would otherwise apply, and that non-security transfers of accounts should be in the Act for this reason.

Preliminary conclusion

In my view, it is clear from the above discussion that there are good policy reasons for extending the reach of the Act to include transfers of accounts even if they do not secure payment or performance of an obligation. I am also satisfied that receivables financings are an important feature of our financial system, so that it may cause “significant disruption” if transfers of accounts were not covered by the Act. And even if it could be argued that insufficient evidence is available to support that assertion, it must also be said that that the case has not been made for amending the Act to take transfers of an account out.

The author went on to explain that, during the consultation process, his preliminary conclusion was supported by the vast majority of stakeholders, and he confirmed his view that outright sales of receivables should continue to be within the scheme.²⁷

4 Registration for effectiveness in insolvency

In this section we ask whether outright sales of receivables should have to be registered if they are to be effective in the Supplier's insolvency, as against the liquidator, administrator or trustee in bankruptcy - in other words, whether registration should be required for "perfection" as well as for priority, as we recommended in the previous Part of this paper. As we noted at the start of this paper, Article 9 of the UCC and most PPSAs require registration for the perfection of outright sales of trade receivables.

4.A REASONS FOR REQUIRING REGISTRATION

The reasons for suggesting registration for the purposes of perfection are reasons 3-5 in the summary given earlier. A full discussion of the reasons will be found in the *Registration* paper. They seem to apply to outright sales of receivables just as forcefully as to charges over receivables. They amount to a prima facie case in favour of registration. What are the possible disadvantages?

²⁷ Recommendation 9.

4.B POSSIBLE DISADVANTAGES

We have identified four possible disadvantages:

4.B.i *The cost of registration*

Registering an outright sale of receivables will involve effort and paying a registration fee. However, we understand that the vast majority of receivables financing arrangements are non-notification arrangements and that in most cases the Receivables Financier takes a charge over the Supplier's receivables as well as an outright assignment of them. Thus any additional effort and cost will be limited, and will normally occur only with factoring arrangements. Moreover, the cost of registration will be substantially reduced if a notice-filing system is introduced, so that a single registration can cover a series of transactions (both charges over and sales of receivables).²⁸

4.B.ii *The risk of failing to register*

If registration is necessary for perfection, and not just in order to secure priority, clearly the risk to the Receivables Financier who fails to register is increased: the likelihood of the same receivables being assigned twice is fairly low, whereas the chance of the Supplier becoming insolvent is quite high. However, it seems unlikely that Receivables Financiers would forget to register an outright sale. Registration would become a standard step in the process of setting up a receivables financing arrangement, and as the transaction is likely to be recorded on the financier's IT system, registration could probably be made more-or-less automatic.

4.B.iii *Publicity*

Earlier we noted that some Suppliers are concerned over publicity. We pointed out that if the new scheme is limited to making priority depend on registration, a Receivables Financier who can be persuaded to trust the Supplier to have revealed any previous assignments and not to make any further assignments of the same receivables has no need to register. If the scheme is extended to registration for the purposes of perfection, then the Receivables Financier will almost certainly insist on registering and this "response" to the publicity argument falls away. However, the other reasons we gave for thinking that registration will not cause publicity problems, or no greater problems than exist at present, remain applicable.

4.B.iv *A greater need for careful definitions and exceptions*

What seems the greatest risk is that assignees may be uncertain what transactions need to be registered and which do not; and the risk is greater if the consequences of failing to register when this is required are more serious. We accept that if we cannot come up with adequate definitions and lists of exceptions to the need to register, the scheme may be unacceptable. It is to this issue that we now turn.

²⁸ See above, p 5.

4.C CONCLUSION ON REGISTRATION FOR EFFECTIVENESS IN INSOLVENCY

We think that there is a good case for requiring the registration of outright assignments of "bog standard" trade receivables if the assignment is to be effective in the Supplier's insolvency. The case is not quite as clear-cut as the case for "voluntary" registration for the purposes of priority; but (at least with appropriate definitions and exceptions, on which see the next section) we consider that requiring registration would provide useful information to credit rating agencies and other persons dealing with the supplier at very little extra cost or risk, as we envisage that most receivables financiers would register anyway to safeguard their priority.

We note that the Law Commission, in its Report on *Bills of Sale*,²⁹ has recommended that general assignments of book debts should continue to be registrable;³⁰ their provisional proposal to that effect on consultation was supported by everyone who responded on the issue.³¹ The Law Commission was addressing only registration for the purposes of effectiveness in insolvency, it does not discuss the issue of priority of competing assignments. If there is a case for requiring registration when an unincorporated business assigns its receivables, there would seem to be at least as strong a case for requiring it when a company does so.

5 Definitions and exceptions

We explained in the Introduction that we have so far been considering the case for bringing "bog-standard trade receivables" into the scheme of registration and priority. How precisely should trade receivables be defined? Should other kinds of receivables be brought into the scheme as well? In what circumstances should an assignment of a trade receivable be excluded, so that registration is not required?

5.A THE DEFINITION OF "RECEIVABLE"

Definitions of "receivable" or its equivalent for the purposes of legislation on security interests differ; but in most cases are quite broad. The Law Commission reported:

...[T]he CR³² used a broad definition of an account (which we now refer to as a 'receivable'), taken from the Revised Article 9 of the UCC. Previously, the UCC had used a much narrower definition, but it had been expanded

²⁹ Law Com No 369, 2016.

³⁰ Para 9.16.

³¹ Para 9.13.

³² *Company Security Interests: a Consultative Report* (Law Com No 176, 2004)

because securitisers in the US wanted all the types of monetary obligations commonly securitised to be included. After discussions with experts on English securitisations, we understand that in the US securitisers face legal risks that are not present here. Here the main pressure for change is among those involved in factoring or discounting agreements. We found no wish to extend registration to the broader types of receivable used in securitisations. We have therefore defined 'receivables' more narrowly, in a way that the FDA consider will meet their needs and no more.

Our definition centres on monetary obligations arising from the supply of goods and services (with the addition of the supply of energy and brokerage fees, which might not otherwise be included). As we discussed in the CR, it does not include repayments for loans.³⁰ We did not wish to include loan participation agreements or interfere with borrower's right to prohibit the assignment of a loan ... It is also worth pointing out that the definition does not include rent, mortgage repayments or sums due under an insurance contract.³³

We think that this is the correct approach. However, since the Law Commission's Report was published, the Small Business, Enterprise and Employment Act 2015 has given Government the power to override bans on assignment in trade receivables contracts. The definition in the 2015 Act was aimed at the same general class of receivables and was carefully discussed by the Government and stakeholders, so rather than adopt the definition put forward by the Law Commission, it seems sensible to follow the definition in the 2015 Act. Thus a receivable would be within the scheme if it is payable under

- (a) ... a contract for goods, services or intangible assets (including intellectual property) which is not an excluded financial services contract,³⁴ and
- (b) at least one of the parties has entered into it in connection with the carrying on of a business.³⁵

5.B EXCEPTIONS

5.B.i *Assignments that do not have a financing purpose*

There are some situations in which receivables as defined above are assigned but not for the purposes of receivables financing. The Law Commission proposed a list of exceptions when

³³ Law Com No 296, paras 4.26-4.27.

³⁴ This includes regulated agreements within the meaning of the Consumer Credit Act 1974 and contracts for financial services as defined by s 2 of the 2015 Act: s 1(4).

³⁵ Small Business, Enterprise and Employment Act 2015, s 1(3).

outright sales of receivables would fall outside the scheme it proposed.³⁶ The list follows the exemptions found in Article 9 and the PPSAs:³⁷

- (1) the assignment of an unearned right to payment under a contract to a person who is to perform the transferor's obligations;³⁸
- (2) the assignment of receivables solely to facilitate collection on behalf of the person making the assignment;³⁹
- (3) the assignment of a single receivable to an assignee in full or partial satisfaction of a pre-existing indebtedness; and
- (4) the sale of receivables as part of the sale of a business out of which the receivables arose.

The Law Commission reported that respondents accepted the list without criticism⁴⁰ and proposed the same exceptions in its final report.⁴¹ We think the case for these exceptions is so obvious that they do not need further discussion, but of course we invite comments and suggestions of any other general exceptions that readers think should be made.

³⁶ Law Com CP No 176, para 3.62.

³⁷ See UCC § 9-109(d) and, e.g., Saskatchewan PPSA 1993, s 4

³⁸ See RCC Cuming, R Wood and C Walsh, *Personal Property Security Law*, 2d ed. (Toronto: Irwin, 2012), at 172: "This exclusion addresses situations where there is little or no chance of third-party deception because the transferee steps into the shoes of the transferor who is no longer in a position to deceive third parties into thinking that he is in a position to receive payment under the contract." The transfer might be by way of novation of the contract as a whole, in which case the transaction would anyway fall outside the scheme; but it is possible that there is an assignment to a party to whom the assignor has simply delegated performance, without a novation agreement. This exception therefore seems worth keeping.

³⁹ The policy basis for this exclusion, in the context of the Canadian PPSAs, is explained in Cuming, Wood and Walsh, at 172 thus: "Since the transferee remains the agent of the transferor, she is not an independent transferee so as to be capable of asserting priority over another transferee." Obviously there need be no assignment to a person who is merely to act as agent for the creditor; but equally the arrangement might be made by way of assignment. Therefore this exception also seems worth keeping.

⁴⁰ The CLLS FLC disagreed with the exception of sale of accounts as part of the sale of a business, arguing that it could have a financing purpose if the sale was part of a whole business securitisation. The Law Commission commented that it could not envisage a case that would fall within the scheme: Law Com No 296, para 4.31 n 33. We share the Law Commission's difficulty.

⁴¹ Law Com No 296, para 4.31.

5.B.ii *Negotiable instruments*

For the sake of clarity if nothing else, it should be made clear that scheme we propose will not affect the rights of the holder of a negotiable instrument that is provided by the Supplier in lieu of payment.⁴²

5.B.iii *Exceptions from registration for perfection*

The Law Commission also proposed one exception to the need to register in order to perfect an outright assignment. We quote:

The working group set up by the FMLC suggested that there might be a different rule for assignments of receivables made on a 'one-off' basis, to protect an assignee who did not realise that it should file. In the CR we asked whether we should adopt a rule found in Revised Article 9 of the UCC Section 9-309 has the effect that an assignment of accounts receivable 'which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts... does not need to be registered and has priority from the date it is taken.'⁴³ The Official Comments note that the purpose of this provision 'is to save from ex post facto invalidation casual or isolated assignments - assignments which no one would think of filing...'⁴⁴ The FMLC then expressed concern that the rule might give rise to uncertainty about whether a particular assignment amounted to a significant part of the assignor's outstanding accounts.

The exemption is designed to prevent 'the assignment which no one would think of filing' from being rendered ineffective even though its absence from the register is highly unlikely to prejudice a subsequent receivables financier or other creditor. We think the relevant test is whether the sale (by itself or in conjunction with others to the same party) is material to the later financier's or creditor's decision. If not, no harm is done by its non-registration. We can see that in principle there may be litigation about this question, but the rule is not likely to produce any great uncertainty in

⁴² Cf Law Com No 296, draft Bill, cl 30.

⁴³ In other words, it will have priority over assignments that are filed later, but be subject to any that have been filed already.

⁴⁴ Official Comment 4, which goes on to note that any person regularly taking assignments of any debtor's accounts should file.

practice. The assignee of a single receivable who wishes to avoid any possible dispute can do so by filing, whether it needs to or not.⁴⁵

The Law Commission went on to recommend that

... a sale of receivables does not need to be registered if the sale (by itself or in conjunction with other sales to the buyer) is of such a small proportion of the assignor's receivables that it would not influence a reasonable person deciding whether to make an advance to the company. For priority purposes, it should be treated as if it had been registered on the date of the sale.⁴⁶

We are inclined agree with the Law Commission's reasoning and recommendation, but we welcome comments.

6 Conclusion

Overall, the provisional view of members of the STR project is that the proposed scheme should apply to outright sales of "receivables" as defined in the Small Business, Enterprise and Employment Act 2015 for the purposes of priority, so that priority over competing assignments of receivables, whether sales or by way of charge, will be determined by the order of registration. We also think there is a good case for providing that an outright sale of receivables that has not been registered before the onset of the Supplier's insolvency should be ineffective against the Supplier's liquidator, administrator or trustee in bankruptcy. The scheme should not apply, however, to sales of receivables that do not have a financing purpose; and there should be no requirement to register a sale of receivables if the sale is of such a small proportion of the Supplier's receivables that it would not influence a reasonable person deciding whether to make an advance to the Supplier.

PROFESSOR HUGH BEALE

30TH DECEMBER 2016

⁴⁵ Law Com No 296, paras 4.32-4.33.

⁴⁶ Law Com No 296, para 4.34.