ON FACTORING OPERATIONS

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I. INTRODUCTION

1. Competition on the market takes place in two main areas. In one area it concerns goods for sale. Goods sell the more readily the more modern and durable they are and the lower their comparable prices are. To that end, commodity producers have to keep abreast with technical advance in production, which, given the relatively rapid moral amortization of machinery and equipment, calls for successive investments at short intervals. The money market soon reacted to this phenomenon and, through the provision of investment finance, found a way to facilitate technical development efforts by businesses. *Leasing* enables businesses to modernize machinery and equipment without having to tie up sizable working funds and to establish reserve funds in order to finance new investments required within relatively short periods of time.

However, there is competition in respect not only of the utility of goods and their production costs, but also of the determination of commercial terms and conditions. The easier the terms fixed by seller (producer) the easier the marketing of his goods. At times supply outgrows demand, with even lower-grade goods selling easier if facilitated by conditions of payment. Sale on credit, even though at a short date, requires seller to draw on his capital, a situation which may easily cause small and medium-size businesses as sellers to become immobile; their balance is active, but their solvency may be imperilled. In this area, too, the money market has found a way to relieve the producer, or supplier —by means of *factoring* operations— [1] of the burden and risk of granting credit.

[1] By *seller* is henceforward meant a person or an enterprise granting credit to

2. Factoring is essentially a financial transaction by which the seller (producer) assigns, for an appropriate fee, the account receivable arising from his sale on credit at a short date to a third person (factor), who guarantees collection of receivables from the debotor (buyer) and also accepts the risk of failure in collection.

This phrasing is not a definition, but merely a broad outline of factoring operations, a wide variety of which has developed over the past decades and which, like leasing, are covered by few legal systems. The transaction between seller and factor includes elements of purchase of receivables, rules of assignment, elements of credit insurance, and undertaking of guaranty. Since the relevant rules of domestic laws are normally dispositive, the nature of factoring can be ascertained from the conditions of factoring contracts rather than from the provisions of law.

3. A factor's business partners are not large companies and transnational corporations, which are not pressed for capital. He helps small and mediumsize companies to hold their ground in the competition on the market, those who would otherwise be incapable for competing with large companies of solid capital in respect of condicions of payment, provision of credit, etc. While sale on credit may immobilize a company, and bank credit is, especially in periods of inflation, expensive, with interest rates likely to exceed the profit rate, the cost of a factoring contract is calculable in advance, such contract relieving the creditor company of the risk of granting credit and of the trouble of collecting debts.

4. A factoring contract is a continuing arrangement for a longer period of time, one under which the factor purchases or acquires the merchant's, or supplier's receivables. The mode of acquisition is mainly assignment, which is communicated to the buyer on the invoice together with instructions to pay the factor directly. If the factor has accepted the risk of the debtor's insolvency, he cannot claim from the assignor the recovery of uncollectable receivables. The factor may also provide other services such as maintaining the seller's accounts, keeping a bill diary and obtaining data concerning the buyer's credit

the buyer even if the object of contract is not sale of goods but supply of services. *Factor* means the "money-man", enterprise or bank who/which acquires the invoice for sale on credit under a contract with the seller. I did not try to coin a Hungarian equivalent of the term "factor". During the economic crisis of the 1930's there operated also in Hungary so-called credit bureaus which undertook to collect the debts of merchants on the brink of ruin, but their activity was not as manifold as is that of the factor today.

standing. For all these services the factor is entitled to a percentage share, as fixed by contract, in the receivables assigned to him. In addition, he has a right to the discount, due to payer before due-date *(cassa sconto)*, from the face value of the invoice purchased as well as to the securities, if any, that provide cover for the receivables assigned.

Factoring is not covered by separate laws even in countries where such contracts are a daily practice on a mass scale. Hence it is the factor and his business partner who try to regulate their legal relationship within the framework of the general rules of law. The situation is different in the United States, where the regulation of such transactions is based on a revised wording of Art. 9 of the Uniform Commercial Code. This relates to financial transactions covered by security. In England the 1925 Law of Property Act contains provisions that can be suitably applied to factoring operations.

II. Development of Factoring Operations

5. Legal literature originates the modern institutions of law from the Roman law or from documents of Egyptian or Caldean law of still earlier times. Factoring shared this same fate. Acoordingly one source [2] has it that in the third millenium B. C. our merchant ancestors found a way to ensure that their receivables did not prevent them from disposing of their money, namely they assigned their receivables to a third person for payment of cash. It was also customary that they so assigned their future receivables before credit had been granted. Moreover, there were cases in which the money-man gave guaranty for payment by debtor.

Indeed, all these examples reveal every essential criterion of factoring operations, yet doubt is raised by the fact that the only evidence of this is provided by a Babylonian relief which shows two men shaking hands and a third writing, presumably committing to writing a financial transaction sanctioned by handshake.

I do not think we should rely on Babylonian clay tablets for an understanding of modern factoring. What in the last century emerged by the name of factoring was not based on Babylonian law.

6. This type of contract has evolved in the United States, mainly in the textile and garment industry. Until the end of the last century

[2] Livijn, Claes-Olof, *Factoring Hanbuch 1982*. Fritz Knapp Verlag, Frankfurt a/M. This edition is a volume of studies by several prominent authors and will hereinafter be referred to as *Handbuch*, with the author's name and page number.

the United States depended on imports in this field, and the foreign (mostly British) merchant handled imports through a *commission agent* (factor).[3] As can be seen, the factor was originally an agent who was selling and purchasing goods on his own behalf, but for other people, while he might have been engaged in other lines of commercial activity. The foreign businessman needed the factor because the latter was familiar with the market and the buyers' solvency. When he sold goods on credit to his customer, he either undertook guaranty in respect to the consignor or paid the bill and ran the risk of the debt proving uncollectable. Of course, it was the factor himself who collected the receivables (he made a contract on his own behalf) and did bookkeeping for the owner of goods.

7. As the textile industry of the United States had been developing vigorously towards the end of the last century the government resorted to protective tariffs to secure growth, thus displacing textile imports. The factor's activity on the foreigner's authority was on the decline, and he therefore turned his attention to domestic (American) companies, which, with full knowledge of the domestic market, no longer commissioned the factor to conclude contracts of sale, leaving to him only the *financial* aspect of transactions (financing of sales on credit, collection of receivables, maintenance of accounts, etc.). With the commission agent's contract-making activity ended, the word factor saw its meaning "commission agent" weakening, and the commission merchant also came to be called "agent" in Anglo-Saxon law.

In the 1920's the factor provided two main services in the United States: paid in advance the face value of the invoice for the goods sold on credit or accepted the risk of the buyer's insolvency, provided that the seller had granted credit with the factor's prior consent. This guaranty (guaranty factoring) was independent of payment in advance.

In the 1930's the insurance companies of New York protested against guaranty factoring as it was actually insurance. Accordingly this kind of transaction is insurance and does not form part of the factor's activity.

The factor had to give up guaranteeing the buyer's solvency, or accepting the risk of his insolvency. Instead he *purchased* his business partner's receivables on condition that in case of insolvency he would not claim recovery of the "purchase price". This is how purchase factoring established itself some 50 years ago.

[3] *Oxford Dictionary:* factor = agent, deputy; merchant buying and selling on commission.

8. Factoring regained momentum from the 1960's onwards, first in the United States, and was soon transplanted by the advance capitalist countries of Europe. The finance provided by factoring was developing parallel to the increase in the volume of world trade. In 1960 the factoring companies financed 5 billion dollar worth of receivables in the United States. During 20 years this figure increased to 30 billion by 1980. In 1985 the value of transactions conducted by the 28 large factoring companies of the United States surpassed the 45 billion dollar mark.[4] At the same time the volume of factoring operations in the 10 advanced capitalist countries of the world amounted to 90 billion dollars.

III. Types of Factoring Contracts

9. The foregoing makes it clear that the contract made by the factor is an innominate one, is unregulated, but is permitted by the general rules of law and is consequently binding on the parties. The factor may provide various services. Therefore the diversity of factor's services allows literature to distinguish a wide variety of factoring contracts by denominating them.[5] These include

(*a*) real (standard or old-line) factoring, the commonest form of the transaction: the seller sends the buyer the invoice indicating, mainly with a rubber-stamp, that the factor had acquired the amount of the invoice by way of assignment. At the same time he sends a copy of the invoice to the factor, who remits to the seller the amount (usually 80 to 90% of the face value) as fixed by the contract between themselves. If the buyer pays at maturity the difference retained is settled between the seller and the factor. If the buyer is insolvent, the factor pays under his *del credere* obligation or settles accounts with the seller;

(*b*) collection factoring *(Fälligkeitsfaktoring)*: the factor accepts the receivables only for the purpose of collection, and does not anticipate payment nor accepts responsibility for non-payment by the buyer or his bankruptcy;

(*c*) factoring without *del credere (unechtes Faktoring)*: the factor pays the invoice in advance, but the advance is repayable in case the amount cannot be collected from the buyer;

(*d*) hidden factoring *(stilles Faktoring)*: it is resorted to by the parties when, for business considerations, the seller is unwilling to dis-

[4] *Die Bank*, 1986, No. 5.
[5] Schepers, G., *Handbuch*, pp. 67 et seq.

close that he does not rely on his own capital for granting credit to the buyer. In that case the buyer is not notified of the assignment on the invoice, which indicates nothing but the bank and the account to which payment should be made. Should the buyer still remit his debt to the seller, such remittance is a legally valid discharge of his obligation;

(*e*) export and import factoring: these are interrelated transactions relied upon chiefly in case the seller grants credit to a foreign buyer. The factor transfers the receivables assigned to him to a factor operating in the buyer's country. The former is tre export factor and the latter the import factor, who is not in a legal relationship with the seller; the transfer of receivables is based on the contract entered into by the two factors.

The above listing is not exhaustive and, this should be emphasized, is one of types of contract, not of legal categories.

10. Classification in English literature is by distinction between the factor's services rather than the contents of contracts. Since the factor acts under contract, there are many overlaps between the two approaches, yet an enumeration of some factoring contracts seems to be in order.[6]

(*a*) Pay-as-paid factoring: the factor pays the invoice not in advance, but upon his collection of receivables.

(*b*) Guaranty factoring: the factor does not pay the invoice except in case of the debtor's insolvency (a kind of *surety*). The insurance companies protested against this guaranty (see para. 7), out of which.

(*c*) Purchase factoring emerged: the factor purchases the seller's receivables or unpaid invoices at his own risk.

(*d*) Loan factoring: the factor grants a loan amounting up to 85 or 90% of the face value of the invoice by way of advance payment. If the receivables prove uncollectable, ha may claim recovery of the payment made in advance. The security of the loan is the assignment itself, which makes for a faster collection of a debt than would be the case if the factor facilitated the loan for chattel mortgage or encumbered immovable property with it.

(*e*) Day-to-day factoring: the factor undertakes to pay should the buyer fail to do so within a certain time-limit. It differs from guaranty factoring (subpara. /b/) in that the due-date is fixed by a contract, not between the seller and the buyer, but between the seller and the factor.

[6] Chiesa, D. A., *Handbuch*, pp. 37 et seq.

(*f*) Split factoring: large factoring companies sahre the risk with two or more other companies, thus financing the seller's credit transactions. The clients themselves see advantage in this, and they do not entrust and assign all their receivables to a single company.

(*g*) Informational activity: the factor is familiar with the market and the companies on it. Even if a businessman has no need for a factor's financial transaction, receiving from the factor constant information about the market situation and about different companies in general is helpful to him.

11. A factoring transaction establishes a bilateral legal relationship between the parties, but its effect extends to third persons who are not parties to the contract, yet they are linked to the factoring transaction also by a contract establishing a bilateral legal relationship. The debtor (buyer) whose debt is transferred by the seller to the factor has entered into a contract of sale with the seller for *future* payment. If the contract of sale is made with a foreign buyer, the export factor transfers the receivables to the import factor operating in the debtor's country, under a contract made between the two factors.

In what follows we shall naturally confine ourselves to the contract between the factor and his business partner, the seller, discussing not all types of factoring contracts, but dwelling on oldline factoring representing the commonest form of traditítonal factoring operations. The substance of this is the seller's obligation to offer *all* his receivables to the factor, who must accept those of them arising from a contract of sale made in accordance with the stipulations of the factoring contract. The assignee of such receivables is the factor, who pays a large part of the invoices without delay and accepts the risk of the debtor's insolvency. The factor is not under an obligation, but has a right to accept receivables arising from a transaction disregarding the stipulations of the factoring contract.

IV. Del credere

12. The greatest risk is naturally incurred by assumption of *del credere* obligation among those undertaken by the factor, which means that the invoice must be paid by the factor if the receivables prove uncollectable. This obligation is regarded by literature as surety [7] and is governed by the rules applicable to surety. I could not recommend any other legal qualification, but one should bear in mind the diffe-

[7] Böhm, A. — Prof. Enderlein, *Der Factoring-Vertrag,* AW Recht im Aussenhandel, Berlin, DDR, 1987, No. 91.

rences accompanying the similarities between surety and *del credere*, a reason why I referred to *del credere* as "a kind of surety" in para. 10 (*b*).

The risk *del credere* assumed in factoring operations is different even from its general concept as know in business life. Factoring is a credit transaction as well. The factor assumes *del credere* risk by *immediate* payment of the invoice (or, more accurately, the larger part of its face value as stipulated in the contract). If the debtor fails to effect payment, the factor cannot claim recovery of his money. In commercial practice the commission agent assuming *del credere* obligation will *never* pay immediately if he is entitled to grant credit; he is to pay only when the buyer fails to pay at maturity or the sumcredited to him proves uncollectable. The advantage of *del credere* assumed in factoring operations is precisely in the factor paying before duedate.

The factor's assumption of *del credere* obligation differs also from surety. In commercial life surety involves joint and several liability, with the guarantor obliged to make payment if the debtor fails to do so at due-date. What the guarantor actually undertakes to do is not to pay himself, but to go surety for payment by the direct debtor. His performance of the obligation assumed *will* fall due if no payment is made. *Del credere* liability is not that cogent as it does not give rise to a claim except in case of receivables becoming uncollectable, of debtor's bankruptcy or insolvency. Simple negligence on the part of debtor, his reluctance or momentary financial difficulty is no ground for a claim. If the factor brings action against the debtor, the seller must await the outcome thereof. And if the buyer lodges a complaint against the goods supplied, which he may even bring up against the factor's claim, the factor must also repay the sum of money he received at the time of assignment.[8]

13. In the contract the factor specifies the sales on credit for which he undertakes *del credere* risk. If the receivables came into being in a manner other than that prescribed by the contract, he is not under obligation to accept risk; he may accept performance and assignment and may even attempt collection, but in case of failure he owes nothing to the seller.

The general contract between the parties specifies the global amount undertaken by the factor or, if he knows his partner's customers, the highest credit limit he approves in respect of each customer. This limit

[8] Here I do not mention bank guaranty, the strictest form of suretyship, which is unrelated to the underlying transaction.

is not rigid, however. As the buyer's credit standing is subject to change, the respective limits are treated with flexibility in the general contract between the parties. The substance of this lies mainly in the factor's unilateral right to notify the seller in writing from time to time of the amount up to which each of his customers is solvent. The factor undertakes no risk in respect of receivables above that ceiling. Such notification does not of course apply to transactions already concluded.[9]

V. Assignment

14. In para. 7) dealing with changes in the scope of the factor's activity we have mentioned that assumption of *del credere* risk was regarded as insurance against damage. Therefore the factor assumed the risk in another legal form, acting as *buyer* rather tham assignee: he purchased his partner's receivables and undertook not to claim recovery of the purchase price should some receivables prove uncollectable. In other words, it was not the factor who undertook no guaranty for payment, but the creditor selling his receivables who did not undertake guranty for the collectability of the receivables sold. This arrangement is possible under article 330, para. 1 (*a*), of the Hungarian Civil Code, provided that the assignor transfers his receivables *explicitly* as a doubtful claim. Other modes of transfer of pecuniary claims are not covered by the Civil Code.

Under numerous legal systems, however, there are two ways of acquiring receivables: assignment and purchase. Acquisition by assignment requires no countervalue (*consideration* in Anglo-Saxon laws), but purchase is a transaction entered into always for a valuable consideration.

15. Also, by virtue of the provisions of the French Civil Code rather than because of protests by insurance companies, factors in France acquire seller's claim not by assignment, but by reliance on the legal institution of *subrogation*.

Under the French Civil Code, assignment is a bilateral transaction between assignor and assignee (Articles 1689 *et seq.*) and its validity with regard to the rights of third parties, particularly in case of the assignor's insolvency, and to the assignor's creditors or to bankrupt's estate is subject certain formalities. As dozens or hundreds of assignments cannot be made subject to formalities in business life, factors

[9] Cassandro, B., *Il Factoring in Europa*, Giuffré Edition, Milano, p. 221.

in France have recourse to *subrogation* as a mode of transfer of rights governed by Article 1250 of the Code. It is an onerous mode of transfer subject to a single formal incident, namely acknowledgement of the transfer of rights *(quinttance subrogative)*, which must show that the factor has paid *simultaneously* with the transfer of rights. Simultaneity is an absolute requirement for such transfer to have legal effect. Of course, the debtor of the right transferred must be notified of any change in the person of creditor, but such notification is subject to no formal requisites whatever: it may be given even by telephone, provided that the factor undertakes to give conclusive proof that communication was made in that way. For the most part, however, the debtor is notified with a stereotyped text on the invoice, together with a warning that payment with legal effect can be made only the new creditor.[10]

16. As noted earlier, assignment effects the interests of third persons as well, in the first place those of the debtor and in the second place those of the assignor's creditors, for whom the receivables assigned could have provided cover. Consequently, certain legal systems make the validity of assignment subject to its notification to the debtor. Provisions to this effect are contained in Article 398 of the BGB (Federal Republic Germany) as well as in English, American and Dutch laws, the latter also requiring certain formalities to be observed unless the debtor acknowledges in writing the fact of assignment. On the other hand, Belgian law is content with assignment being indicated on the invoice sent to the debtor. *Subrogation* as applied under the French Code is different from assignment in thet it can be invoked *vis-à-vis* anyone at any time.

Hungarian law recognizes the validity of assignment even in the absence of notification to the debtor, its only consequence being that the debtor may pay the assignor and that such payment terminates his obligation (Article 328, para. /2/, of the Civil Code). Under Swiss law too, notification is not an intrinsic incident of assignment, but payment to the assignor relieves the debtor of his obligation only if payment has been made in good faith (Article 167 of OR).

17. The question may be asked whether it is not a simpler procedure for the debtor to give a bill of exchange for his debt, which can be handed the factor by mere endorsement.

Experience shows that most companies taking short-term credit refuse to give bills of exchange, and rightly so. A company complaining

[10] Gavalda, *Subrogation und Cession*, Handbuch, pp. 144 et seq.

of the goods supplied or having a counterclaim against the seller cannot assert its right *vis-a-vis* a bill's endorsee. Assignment or purchase of receivables does not worsen its position as debtor. None of its complaints and counterclaims arising from the underlying transaction can be invoked against the seller's *bill* successor in title by a simple endorsement of the bill.

Moreover, the factor acquiring a claim based on a bill of exchange actually discounts a bill, that is to say, carries out a banking activity. The activities of the factor and the bank do not differ sharply, both being credit transactions. Yet the bank, by discounting a negotiable instrument, does not undertake a risk similar to that of the factor, which means not only that complaints arising from the underlying transaction cannot be invoked against the bank, but also that if the debtor fails to pay at maturity the amount shown on the bill, the bank may bring an action for collection of debt not only against the drawee, but against anyone whose signature on the bill precedes that of the bank, naturally that of the person in particular who endorsed the bill for the bank. Accordingly, however, the discount rate is also lower than the amount of money retained by the factor at the time of acquisition of the claim.

18. The sale of rights is not regulated by the Hungarian Civil Code, under wich the object of sale is a thing, while assignment is a regulated mode of transfer of rights. According to para. (2) of Article 330, assignment for a valuable consideration is governed by the rules of sale and gratuitous assignment by the rules of gift.

However, application of these rules to factoring operations is not free from problems.

Factor and seller enter into a contract for a longer period of time, usually for one year and less frequently for two years. An essential provision of their contract is that the receivables specified therein must always be assigned by the seller to the factor, who is to effect payments in view of the amount of such receivables. Is this (general) contract a final or a preliminary one? Is there a need for some sort of a separate agreement for the assignment of each receivable or does a long-term contract prescribe obligations for the seller to assign his receivables and for the factor to pay a valuable consideration? Every general contract is fulfilled by a series of "legal acts" performed during the period of its operation. These "legal acts" are performed in *fulfilment* of the general contract and performance can be *demanded* without conclusion of a new contract. Thus the general contract is not a preliminary one, for what the parties undertake to do is not to

sign a final contract, but agree to establish a lasting legal relationship and determine the obligations felling on them during the continuance of such relationship. From the seller's point of view, such obligation means that he, after having undertaken to assign all receivables arising in the course of his business, must assign each receivable at the time it comes into existence.

19. Nevertheless, the terseness of the Civil Code gives rise to uncertainty in this respect as well. According to the commentary on Chapter VIII of the Civil Code, a claim *falling due* in the future and subject to conditions can also be assigned, but assignment is *not valid* if it relates in general to the assignor's claim *arising* in the future,[11] although this is precisely the object of the factoring contract.

Factoring operations may serve to provide facilities for the Hungarian economy, particularly when the limited foreign exchange availabilities of enterprises do not allow them to grant credit. The aforementioned commentary on assignment should therefore be revised so as not to impede transactions of such a nature.

Assignment by contract is covered by three articles of the Hungarian Civil Code. Article 330, para. (2), provides that assignment for a valuable consideration must be governed by the rules of sale, but, according to the commentary on sale, a contract can also be made for a *future* thing, the buyer to pay only when "the object of sale actually comes into existence".[12] This is a contingent purchase *(emptio rei speratae)*. While the Civil Code does not cover the sale and purchase of rights, its provisions state that the rules of sale, including obviously the sale of non-existent thing, are applicable to such transactions. Indeed, what would make us deduce from the silence of law that the rules of sale do not apply to future claims? A non-existent claim is just as non-existent as a non-existent thing is. If a non-existent thing can be validly sold, what would prevent a merchant wishing to increase his turnover by sale on credit from marketing *in advance* his receivables arising from such operations? Contingent purchase is no gamble: the buyer is to perform only if the thing comes into existence just as the acquirer is to pay for the receivables acquired if they come really into existence. Therefore it appears to me that the maxim of civil law that what is not prohibited is permitted should be applicable to this case.

20. The factoring contract specifies the sales on credit from which receivables arise and which the factor undertakes to finance. It is often

[11] *Commentary on the Hungarian Civil Code*, vol. II, p. 1511.
[12] *Commentary on the Hungarian Civil Code*, vol. II, p. 1709.

stipulated that undertaking of guaranty by the factor requires his written consent to the granting of credit prior to the making of the contract, which means that each transaction is subject to the factor's approval already at the time of offer. Other customary restrictions include setting upper credit limits or confining credit to certain types of contract or limiting guaranty to receivables arising from contracts made in certain geographical regions. The seller must offer all his receivables without exception; "selection" of them is regarded as breach of contract.

21. Of course, claims whose assignment is ruled out by law are not assignable. Claims arising in comercial life are, as a rule, assignable. However, the buyer may happen to rule out assignment in the contract of sale, stipulating that the claim arising against him must not be assigned by the seller to a third person. This is the way taken by large business firms in contracts made with permanent suppliers. If the factor acts as assignee in collecting receivables, prohibition may be a bar to his claim. Although the assignment excluded may be substituted for by an order to collect, this latter applies only until such time as the debtor performs without being sued, for the risk —that of his happening to perform to the seller— subsists. Such stipulation is frequently the case with other types of transaction as well, especially since governments, municipalities and other authorities or public institutions have also relied on credit. Not infrequently, these require that the enterprise with which they entered into a transaction should remain to be the creditor. The reason for this stipulation may be political: an authority is unwilling to be debtor to an uncertain person, but the "caution of bureaucracy" may also play a part, for in a large apparatus notification of assignment may happen to disappear, with the debtor exposing himself to the risk of paying twice. Often the contract is not even seen by the factor, who is informed by a copy of invoice of the amount and due-date of the claim which he pays in advance in accordance with the general contract. The seller answers to the factor for the assignability of claim irrespective of whether assignment is ruled out by law or by contract.

22. The Hungarian Civil Code provides no protection for factor. Against the factor's claim the debtor may invoke the exclusion of assignment by the underlying transaction, which is, for that matter, the case in the overwhelming majority of the European legal systems. In the United States restriction of the creditor's right of transfer is no bar to the factor's acquisition of right under the cited regulation by the Uniform Commercial Code. Before that regulation was adopted, practice had provided protection for factors on the ground that owners-

hip includes the right to dispose freely of the object of property and that therefore restriction of that right is null and void, so the factor acquires claims validly because the claim's "owner" is the creditor, who cannot be restricted by the debtor in his right to dispose of the object of property.

According to the commentary on the Civil Code, which is in concert with most European legal systems, the stipulation prohibiting assignment is valid and can be invoked by the debtor *vis-à-vis* the assignee raising a claim against him.[13] This, however, is but an extensive interpretation of Article 328 of the Code, the text of which is silent on preclusion by contract.

Article 222 of the GIW of the German Democratic Republic on international economic contracts expressly provides that assignment may be excluded by contract between the parties.

The Swiss law of obligations (OR) is more nuanced in providing (in Article 164) that exclusion by contract of assignment cannot be invoked against assignee if he acquired the claim trusting he would receive a debenture stock failing to refer to exclusion.

The contract between seller and factor obliges the former to assign his future receivables to the latter, whereas prohibition of assignment is contained in the contract of sale between seller and buyer, to which the factor is not a party and which he does not even see for the most part, but is notified of the performance of the contract of purchase on the invoice sent to him. However, prohibition by the contract between seller and buyer does not entitle him to demand the buyer to pay him, because the assignment did not make him the debtor's creditor. The stipulation of the factoring contract under which the seller undertook to assign his claims is not invalid by reason of the mere fact the seller undertook the contrary in a contract with someone else. The factor retains his right to the receivables, but cannot demand performance from the debtor, although if the latter pays the seller, the factor may demand such payment as his own money rather than as a compensation.

Should the factoring contract come into use in Hungary as well, that situation would merit legal regulation.

VI. Rights transferred by assignment

23. The legal systems are concurrent in stating that by transfer of claims the securities there of (suretyship, lien, insurance, reservation

[13] *Idem*, p. 1509.

of title to property, etc.) are also transferred to assignee. This provision is often contained in factoring contracts.

The regulation by the Hungarian Civil Code of reservation of title to property deserves special consideration, particularly as regards para. (1) of Article 329, which refers, not by way of illustration, to such other right as are transferred by assignment to assignee, but apparently specifying only two such rights, expressing that the rights "derived from lien and suretyship alto devolve on assignee". This provision is silent on, e.g., whether assignee may demand to be the grantee of the security bond if a security is provided for a credit transaction. This does not mean that the terse enumeration as quoted cannot be substituted for by contract between the parties, but the question nevertheless remains of whether the *title to property* retained by agreement between seller and buyer is *transferred* to assignee by way of assignment under contract between the parties.

24. Under some legal systems (such as the French and the Soviet laws), buyer acquires the title to property if the parties agree on purchase and its object. Other laws (e.g. Anglo-Saxon law) leave it to contract to stipulate whether property is acquired by buyer at once or at some later date. The Hungarian law, in a way reminiscent of *traditio* in Roman law, links acquisition of property with possession of the thing. The acquirer acquires the title to property by delivery, by being put into (actual or symbolic) possession of the thing. Before that takes place he does not acquire but a *right to claim* delivery of the thing, which means that his claim is in the nature of a right *in personam*, not *in rem*. If, for instance, during the period between the conclusion of contract and entrance into possession the thing perishes through no fault of anyone, such damage is suffered by seller, not buyer.

These two modes of adquisition of property can be expressed briefly in these terms: whereas in other laws the purpose of purchase in to acquire property, acquisition of property in Hungarian law is a *legal effect* produced in conjunction by the conclusion of contract and the handing over of property. Under Article 117, para. (2), of the Civil Code, the *handing over* of the thing is also required, *in addition* to the contract of transfer or other title, for the acquisition of property. Handing over, or delivery may be effected by putting someone into actual possession or in another way making certain that the thing has passed from the transferor's power into that of the acquirer, so the date of the property devolving upon the buyer is determined by the law, not the contract. Yet a contract is free to stipulate that trans-

fer *should not take place*. Reservation of title to property is laid down in the contract and its validity lasts until payment of the purchase price. Reservation of title to property transferred by assignment is not coupled with putting assignee into possession, since the possessor of the thing has long been the buyer. Accordingly the assignee does not acquire the title to property, but becomes "owner" of the claim of the purchase price and of the claim of a nature *in personam* to the thing from the buyer in case of non-payment. In other words, the factor acquires the claim *in personam* to the security *in rem*. The same conclusion is reached in the commentary on the Civil Code.[14]

25. In describing the types of factoring operations mention has been made of split factoring, in the case of which several factors provide services for an enterprise. This may cause the seller to assign the same claim inadvertently to two factors, but such assignment may have other motives or may be resorted to on purpose. The question is which of the two assignments is of legal effect. The solution of the law is simple: the previous one. This is clearly spelled out in English and German law as well. Under English law, however, the previous assignment is that which is first notified to the debtor, while under German law that which bears the earlier date on the deed. So the question of who is the rightful assignee is to be decided according to the law governing the claim, namely the English or the German law.

A "conflict" of assignments may result not only from contractual transfers by the debtor. A claim to the debtor's receivables as a component of his property may be raised on several grounds. In case of lien based on a court order or on operation of law a claim may be raised by the grantee and, in case of bankruptcy, by the public trustee, while the debtor's receivable may also be claimed, for purposes of cover, on grounds of unpaid taxes, other claims of a public authority or shop rent. The order of priority is naturally determined in like manner by the applicable law.

VII. Import and export factor

26. The terms of general contract between seller and factor remain unchanged in case of seller delivering goods or providing services for a foreign buyer. If he grants the amount of credit as fixed by the contract (normally for a period not longer than 6 months), that invoice may also be assigned to the factor.

[14] *Idem*, vol. I, p. 536.

The factor usually entrusts another factor operating in the debtor's place of business with collecting the foreign receivables assigned to him. If the commission is confined to collection of receivables, it is an act sufficient for the operation, but insufficient for a legal action. As the institution of commission to conduct a lawsuit is unknown to a number of domestic laws, action at law is a simpler procedure if the factor of the debtor's country is to enforce the claim as his *own*, namely if he (export factor) assignes the receivables to the factor of the buyer's country (import factor).

However, the two assignments are not identical. I should note on this score the provisions of the Hungarian Code of Foreign Exchange which do not prohibit a Hungarian creditor from assigning his receivables to a Hungarian factoring company (if such exists), but do lay down rules for cases in which a receivable arises abroad and, still more so, in which the export factor wishes to assign such receivable to a foreign factor. (But let us assume this to be subject to the approval of the foreign exchange authority.)

27. The export factor did not acquire the foreign receivable gratuitously: he paid a large part of it, undertaking *del credere* risk, and the securities thereof devolved upon him. Were he to assign all these to the import factor he could do so only if the import factor pays him all that he did for the assignment. Of course, the import factor does not employ this procedure in all cases, if only for the reason that he was not in a position to have a say in whether the seller should grant credit and to what limit. Nevertheless, factors are usually in close contact. It should also be kept in mind that each export factor may be in contact with as many import factors as are the countries to which his clients export. Nor does an import factor recruit clients from a single country. Large factoring companies form an international "chain", passing transactions to one another and entering into contract *inter se* under separate conditions of their own.

When the seller enters into contract with a local factor he hands him a list of customers showing the credit standing of each. That list, broken down by country, is transmitted by the export factor to the import factor who is in contractual relations with him and who supplies the information required to set the credit limit, for which the factor is willing to undertake guaranty, in the contract to be made with the seller. When the credit granted in this way is assigned the import factor is alto willing to undertake the risk of granting credit.

In countries with a convertible currency the contract between the export and the import factor ensures the seller's appropriate mobility.

Therefore, in countries with a free currency, cases are rare in which the seller, bypassing the export factor, makes a direct agreement with the foreign factor, namely the person operating in the country to which the seller exports. Still, it appears that in a country exercising foreign exchange control direct agreement with the import factor seems to be of greater advantage to the exporter, for the foreign exchange received as a fee for the assignment earned abroad, putting no strain on domestic availabilities, while bypassing the export factor serves to reduce cost.

VIII. International regulation of factoring

28. The international activity of factoring companies has clearly pointed to the possibility for non-regulation of factoring to impede the safety of legal transactions, because contracts of factoring in different countries have been made within legal frameworks designed to meet other demands. As early as 1974. UNIDROIT [15] recognized the need for the regulation of transactions carried out mainly in the international domain, where foreign factors or their partners are likely to be caught off guard. As every-one feels the uncertainty caused by different national legislations, the chance is greater of adopting a uniform regulation of international factoring than of preparing uniform rules in the form of an international convention to govern purely domestic transactions as well. Even in respect of international operations the only realistic goal to pursue could be to subject a few important matters to uniform rules that are acceptable to the different legal systems. The committee entrusted with the elaboration of a draft convention has prepared, after more than ten years of work, draft articles to be finalized by the Diplomatic Conference convened for 1988.

From the foregoing it follows that the draft does not contain detailed rules on factoring. In the few questions covered, the draft proceeds from the freedom of contract, or recognizes the right of the parties to determine the law governing their contract. The parties may do so by excluding the application of the Convention or determining the applicable law in their contract. The right to expres exclusion of the Convention is recognized not only for the parties entering into a contract of factoring; the Convention may also be excluded by a contract of sale between seller and buyer, to which the factor is not a party.

[15] French acronym of the International Institute for the Unification of Private Law, Rome.

Therefore, in the latter case, the draft allows the Convention to be validly excluded in respect only of claims which arose after the factor had been notified of such exclusion.

The Convention is intended to apply to contracts under which the receivables to be assigned by seller to factor arise from international transactions. Such is the case if the places of business of seller and factor are situated in different States. However, even in this case, the Convention is applicable only if seller, his customer and factor operate in contracting States, i.e. if the law of contracting State is applicable to both the contract of sale and the contract of factoring.

29. Assignment is covered by several draft rules.

Future receivables should not and cannot be specified by a contract of factoring, but if they can be identified, on the basis of contract, at the time they come into existence, that is sufficient for the validity of assignment without the need for separate statement of assignment to be given.

Draf rule 5 provides, in conformity with U.S. legislation, that an assignment to the factor is effective even if assignment has been prohibited by contract between seller and buyer.

This provision was included in the Draft after a great deal of debate and on the basis of compromise. Many representatives saw in it a restriction of the freedom of contract, while others deemed it simply incompatible with their respective domestic laws. The U.S.A. delegation was of the view that abandoning this rule would, in relation to their regulation amount to a step backward. The compromise lies in the Draft leaving scope for a reservation excluding the application of this rule if the debtor is doing business in the country making such a reservation.

On the basis of assignment the debtor is required to make payment to the factor if he was given notice of the assignment in writing, the receivable assigned is specified and arose at or before the time the notice was given.

In accordance with the general rule of assignment, the Draft entitles the debtor to raise objections under a contract of sale against the factor as well. Other objections, including plea of set-off, may only be raised in respect of claims existing at the time the debtor received notice of the assignment.

If the debtor paid the factor and subsequently realized that, on account of defective performance, he was entitled to recover from the seller the money paid, he may have a right of recourse against the factor only if the latter has not yet paid the seller the purchase price or

if at the time the payment was made he was aware that the buyer had a valid claim to recover the purchase price. (The relevant article mentions non-performance among the grounds for recovery of the money paid. Considering that the factor joins in the operation only in case of a credit transaction and that the period of credit begins to run from the date of delivery and acceptance, it is difficult to understand the reason for the buyer on credit to pay, and to pay the factor, in case of non-delivery.)

Under the Convention, if assignment takes place between the export and import factors, the draft rules on seller apply to the export factor and those on assignor apply to the import factor.

30. These few questions covered by the entire draft convention are summed up in 11 articles, which constitute the first modest step towards a uniform international regulation of factoring contracts. Disagreements between representatives of different jurisdictions are significant enough for us to be satisfied with this initial step if the rules elaborated so far are ratified by a sufficient number of States.