CROSS-BORDER FINANCE ESSAY

TLC For Your Dutch Collateral: Some Practical Considerations

BY CAMILLE VAN LIEBERGEN

Earlier this year, SFNet announced its second Cross-Border Finance Essay Contest, sponsored by Goldberg Kohn Ltd. Members of SFNet's International Finance and Development Committee judged the essay submissions on content, originality, clarity, structure and overall contribution to furthering and expanding understanding and discourse within the field of cross-border finance. This essay won second place and focuses on how tweaking the borrower's customer contracts can strengthen your position as secured lender.

The authors of the winning essays have been invited to participate on a panel at SFNet's 79th Annual Convention in Orlando, FL, November 15-17.

When a U.S. lawyer and a Dutch lawyer talk about *anti-assignment clauses*, each might misconstrue what the other is talking about. This is caused by differences in law. In the U.S., anti-assignment clauses typically preclude the assignment of the contract itself, but not the assignment of accounts receivable arising from that contract. In the Netherlands, such clauses do preclude the assignment of accounts receivable arising from such a contract. An agreement between parties providing that accounts receivable are not assignable is invalid and unenforceable under the Uniform Commercial Code ("UCC").[1] Dutch law has no such rule. If a Dutch contract contains an anti-assignment clause, it becomes legally impossible to transfer the accounts receivable to another party. Assignment in violation of such a clause does not only constitute a breach of contract; the accounts receivable are simply not capable of being transferred to another party. Dutch accounts receivable that cannot be transferred, cannot be pledged either.[2] A U.S. lender that is lending against Dutch accounts receivable should keep this in mind.

You may ask: When do I have to deal with Dutch law governed accounts receivable? This might be more often than you would think. All it might take is to finance a US parent that happens to have a Dutch subsidiary. In that scenario, the Dutch subsidiary ("DutchCo") may be a borrower. DutchCo probably has multiple customers. As a secured lender, you secure your loan by obtaining all-asset security. In particular, you seek a security interest in the accounts receivable of DutchCo, because they represent a large portion of its assets.

Suppose DutchCo is in default and you decide to collect the pledged accounts receivable. As you want to proceed with collection of the accounts receivable, you are being told that these are not subject to a valid pledge because the underlying customer contracts contain an anti-assignment clause. As a consequence of this anti-assignment clause, the accounts receivable are not validly pledged under Dutch law. You end up empty-handed.

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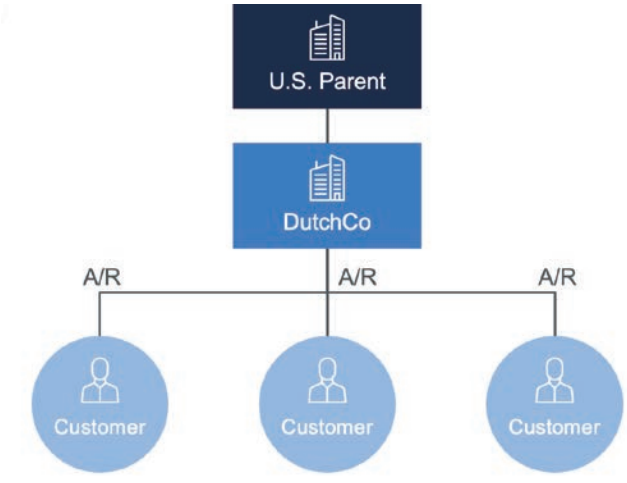
Fortunately, a solution is at hand. Strategically negotiating on the customer contracts applicable in the relationship between the borrower and its customers can help strengthen your position as secured lender. It is worth negotiating with your borrower on the elimination of anti-assignment clauses from the customer contracts.

In this essay, this solution will be further explained. When referring to the contracts or terms and conditions applicable in the relationship between the borrower and its customers, I will use the term customer contracts. The customer contracts of the Dutch borrower may or may not be governed by Dutch law. This essay only covers customer contracts that are governed by Dutch law.



Anti-Assignment Clauses Under Dutch Law

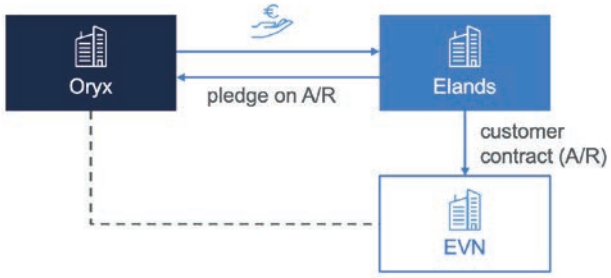
Let's start by focusing on the way Dutch anti-assignment clauses can affect a secured lender's collateral.

In many sectors of the Dutch economy, it is standard practice to include anti-assignment clauses in customer contracts. Such clauses state that the accounts receivable arising from the contract are non-assignable and typically read as follows:

Neither this Agreement nor any of the rights, interests or obligations under the Agreement shall be assigned, in whole or in part, by operation of law or otherwise by either party without the prior written consent of the other party.

> The ability to stipulate that accounts receivable are not assignable fits into the Dutch concept of freedom of contract. Parties are free, within reason, to shape the content of their contract. A debtor may not want to keep track of whom they have to pay. Or a debtor may simply not want to deal with anyone other than the original creditor, for example because a new creditor might be stricter in enforcing the receivable. Including an anti-assignment clause in the customer contracts assures that the debtor has to pay the amount that is due to no one other than the original creditor.[3]

Although these anti-assignment clauses might appear innocuous at first glance, they have consequences for the collateral package of a secured lender. An example of Dutch case law in which the secured lender ended up empty-handed, is *Oryx v. Van Eesteren*.[4] This case concerned lender Oryx (Holding) B.V., who granted a loan to borrower Elands Natuursteen B.V. As security for repayment of the loan, liens were established on all Elands' existing and future accounts



receivable. Elands entered into an agreement with one of its customers, EVN.

The customer contract between Elands and EVN contained an anti-assignment clause, according to which Elands was prohibited from assigning any accounts receivable arising from the contract to a third party. At some point, Elands was in default under the loan. Oryx decided to enforce its right of pledge on the accounts receivable, including those arising out of the customer contract with EVN. When Oryx tried to collect the accounts receivable from EVN, EVN refused and pointed at the anti-assignment clause included in its customer contract with Elands. The question arose whether this anti-assignment clause precluded the validity of the security assignment in favor of Oryx. The Dutch Supreme Court confirmed that (i) the ability to assign accounts receivable can be limited by an anti-assignment clause like that agreed upon between Elands and EVN, and (ii) such a clause not only leads to a breach of contract but also to the invalidity of the assignment of such accounts receivable.[5] As a result, Oryx had no valid pledge on the accounts receivable and ended up empty-handed.

To reassure tempers: not all anti-assignment clauses included in Dutch law governed contracts automatically lead to non-assignment of the accounts receivable arising out of such a contract. It should follow from the wording that parties actually intended to affect the assignability of the accounts receivable in itself.[6] If this is not the case, a valid assignment is still possible, but would constitute a breach of contract.

The bottom line is that contracting parties can agree to exclude the transferability of accounts receivable and thus invalidate any purported assignment or pledge with effect upon any third party.

Dutch legislative proposal "Wet Opheffing Verpandingsverboden"

It is worth mentioning that there is currently a legislative proposal pending in Dutch Parliament to eliminate the ability to contractually limit the assignment or pledging of a business's accounts receivable (the "Act")[7]. If the Act is adopted, contractual anti-assignment clauses will no longer be enforceable. The aim of the Act is to broaden the credit potential of borrowers, enabling them to use their accounts receivable as security for their financing (regardless whether their customer contracts contain an anti-assignment clause). Besides, the Act restores the level playing field with surrounding countries where the effect of anti-assignment clauses has already been restricted or nullified.[8]

The attempt of the Dutch legislature to put a ban on anti-assignment clauses can hardly be found surprising, given the immense role of receivables in financing transactions. The Act puts an end to the uncertainty as to whether certain accounts receivable are capable of being pledged or not. This clarity is highly desirable in the cross-border finance practice.

It is still unclear if and when the Act will be adopted. Until the Act is passed, it is of importance to check whether the borrower's customer contracts contain anti-assignment clauses.

TLC for Your Dutch Collateral

So how should you as secured lender deal with this in practice? Ideally, you identify in advance whether the borrower's customer contracts contain anti-assignment clauses. Suppose you requested the customer contracts from the borrower and after a first review you notice these contain anti-assignment clauses. What to do?

As a secured lender, you can negotiate with the borrower about what is included in its customer contracts. Ideally, any anti-assignment clauses will be eliminated. You can agree that the borrower will remove any such clauses from its existing or future customer contracts, or both. Which solution suits best depends on the borrower's type of business. Several scenarios are conceivable.

Scenario 1

Suppose the borrower has many customers with whom it enters into standard, short-term contracts. These contracts are not negotiated, but are subject to general terms & conditions applicable to all customers. Once these short-term contracts expire, the borrower will enter into a new contract with either existing or new customers. The moment a new contract is entered into is yet another opportunity to negotiate the content of the contract and to eliminate any anti-assignment clauses.

Scenario 2

Another scenario could be that the borrower has several customers but uses bespoke contracts only, negotiated on a customer basis. Such tailor-made contracts are often used only if not many different customers are involved.

Scenario 3

Lastly, it could be that the borrower has only a few customers with whom it entered into standard, long-term contracts. In that case, the recourse of the secured lender is limited to these few customers only. Getting a valid right of pledge over these accounts receivable is thus even more essential.

Ideally, the borrower commits to removing anti-assignment clauses from its future customer contracts. This can be done by including a covenant in the finance documentation (e.g. the Dutch Security Agreement) along the following lines:

> The Pledgor shall not include any limitations or prohibitions to pledge receivables owed to it in any of its standard customer contracts or general terms & conditions.

Committing to such forward-looking covenant should not be too burdensome for the borrower, assuming it enters into standard, non-negotiated contracts with its customers. It only concerns future contracts, which are yet to be entered into. For the secured lender, it increase the likelihood that accounts receivable arising from future contracts can be validly pledged. It will strengthen its position as pledgee by broadening the scope of the collateral. A forward-looking covenant may particularly be helpful in Scenario 1, where contracts are often renewed. Due to such renewal, the abovementioned obligation will apply to all customer contracts within a short period of time.

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The borrower may be in a different position if it does have standard contracts, but these are negotiated with all or some of its customers. In that case, it may be burdensome to agree that no such contract will contain an anti-assignment clause. However, a best efforts commitment might be something the borrower can commit to. The covenant could then read:

> The Pledgor shall use best efforts to not include limitations or prohibitions to pledge receivables owed to it in any of its customer contracts.

If you want to go a step further, you could negotiate that the borrower should reach out to its existing customers to obtain a waiver of any anti-assignment clauses contained in existing customer contracts. This could be done by including a covenant in the finance documentation that may read like this:

> The Pledgor shall use its reasonable endeavours to obtain a waiver from any debtor of Receivables of any limitations or prohibitions to pledge any such Receivables, to the extent the relevant legal relationship with such a debtor contains such limitations or prohibitions.

This may be particularly helpful if the borrower has long-term contracts with only a few customers (Scenario 3) in which case you could draft the covenant to be an outright obligation, not just an obligation to use "reasonable endeavours." If anti-assignment clauses are removed from these long-term contracts, you significantly increase the secured lender's position as pledgee. The scope of the collateral will then be extended to accounts receivable arising from existing contracts as well. However, renegotiating existing commercial contracts might not always be desirable from a borrower's point of view. It might be a big commercial ask, especially if the borrower uses bespoke contracts (Scenario 2). Renegotiating each customer contract may be too much of an administrative burden.

Regardless of the specific scenario, one central message applies to all secured lenders: tweaking the borrower's customer contracts might be helpful in obtaining a stronger position as pledgee.

Conclusion

Negotiating with a Dutch borrower to modify its customer contracts can be an easy fix to strengthen the position of a secured lender. By eliminating anti-assignment clauses from the customer contracts, you increase the likelihood that accounts receivable are validly pledged This can be done by including a covenant in the financing documentation that obligates the borrower not to use anti-assignment clauses in its relationship with its customers. Such covenant can be forward-looking, meaning that it only applies to customer contracts entered into after closing of the financing. However, if you want to go a step further, you could make this obligation apply to existing contracts as well. This should not be too burdensome for the borrower. In the end, the interests of the borrower and lender are aligned: both want a financing on good terms, with low risk and less costs. In the end, obtaining good collateral serves the interest of both lender and borrower: By providing collateral, the borrower's credit potential increases and it reduces interest rates.

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1 UCC §Section 9-406(d)(1).

2 According to Article 3:81(1) in conjunction with Article 3:228 of the Dutch Civil Code ("DCC"), pledges can only be established on transferable property. If, therefore, a creditor and a debtor agree that the accounts receivable are non-transferable, it follows from these articles that such claim cannot be pledged either. This is confirmed by Dutch case law. See Dutch Supreme Court 1 July 2022, ECLI:NL:HR:2022:984 (Rabobank / Ten Berge q.q.).

3 Exclusively for receivables, Article 3:83(2) of the Dutch Civil Code (DCC) determines that their transferability can be prohibited contractually.

4 Dutch Supreme Court 17 January 2003, ECLI:NL:HR:2003:AF0168 (Oryx / Van Eesteren).

5 Via art. 3:98 of the Dutch Civil Code (DCC), all this also applies to the pledge of the accounts receivable in question.

6 Dutch Supreme Court ECLI:NL:HR:2014:682 (Coface / Intergamma).

7 In Dutch the "Wet Opheffing Verpandingsverboden".

8 See for example Germany, Austria and the United Kingdom, where the absolute effect of anti-assignment clauses has already been restricted or abolished.

9 The Act is pending in Dutch Parliament since May 2020 and consideration of the Act was at a standstill for over two years. In June 2023, the Act will be debated again.