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(Independent and) Irrevocable Payment Undertakings

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Aim of the session

To better understand:

- What is an Irrevocable Payment Undertaking (IPU)?
- The market's focus on Independent IPUs (IIPUs)

When is an IPU used?

- As far as we are aware, the term IPU is relatively unique to the payables and receivables finance market … but not unique as a legal concept (Cf. to direct agreements in Project Finance transactions, for example)
- Used mainly in Buyer-led payables finance programmes, but also used in some Seller-led receivables purchase facilities/programmes

What is an IPU?

- What it is **not**:
  - A negotiable instrument–*unless it complies with relevant legislation (e.g. Bills of Exchange Act (UK), Article 3 of the UCC (US), etc)*
  - A security (i.e. tradeable financial instrument)–*usually*
- What it is:
  - A contractual obligation
  - Made by the Buyer (and/or an affiliate) directly to the Finance Provider
  - To pay something on a certain date
  - Expressed as being irrevocable
  - Made in addition to the Buyer's payment obligation under the receivable (which may or may not have been purchased by the Finance Provider)
- As it derives from contract, it is subject to contractual principles–e.g. contract formation requirements and contractual defences and set-offs (unless waived/varied)
- What rights does it give the Finance Provider and/or its assigns? **That depends on what it says!**

Not all IPUs are created equal

- IPUs come in all flavours! Here are some examples:
- Confirmation only
    - A confirmation from the Buyer that the receivable exists and it will pay the receivable when due without any deduction, counterclaim, set-off or withholding (Cf. to an acknowledgment of a notice of assignment)
- Confirmation plus undertaking to pay the receivable
    - Confirmation together with an undertaking from the Buyer, expressed as being independent, that it will pay the receivable on its due date without any deduction, counterclaim, set-off or withholding to:
        - the owner of the receivable
        - a specific bank account or
        - the Finance Provider

Not all IPUs are created equal (contd.)

- Confirmation plus undertaking to pay a confirmed amount
  - Confirmation together with an undertaking from the Buyer, expressed as being independent, that it will pay a confirmed amount (i.e. a specified amount agreed by the Buyer) on the confirmed due date (i.e. a specified date agreed by the Buyer) without any deduction, counterclaim, set-off or withholding to:
    - the owner of the receivable
    - a specific bank account or
    - the Finance Provider

Not all IPUs are created equal (contd.)

- Indemnity – not an IPU but may supplement an IPU
  - An indemnity is a promise to protect a person against loss suffered by that person by paying money to that person in respect of that loss upon a specified trigger
  - Therefore not really an IPU and requires proof of the loss suffered, and potentially liable to certain defences of the Buyer if drafted to vaguely (e.g. lack of causation, remoteness)
  - But may supplement an IPU where it is determined that the IPU is not independent of the receivable and the Finance Provider suffers a loss (e.g. a creditor of the Seller raises a claim to recover from the Finance Provider amounts paid by the Buyer to the Finance Provider in respect of the receivable)
  - Examples:
    - A specific indemnity from the Buyer to indemnify the Finance Provider against losses incurred by the Finance Provider arising out any circumstance where it is determined that any payment made by the Buyer to the Finance Provider is recoverable from the Finance Provider by any third party (e.g. a creditor of the Seller or the liquidator of the Seller)
    - A general indemnity from the Buyer to indemnify the Finance Provider against losses incurred by the Finance Provider in respect of the programme generally

What does "independent" mean in relation to an IPU?

- We are not aware of any court in either the US or England having analysed a purported IPU. There are no specific statutes addressing IPUs and there is no widely accepted definition or interpretation. So the remainder of this presentation is just our view based on contractual principles, plain reading and desired outcomes.
- **Important to note**—separate *does not equal* independent—all IPUs are separate from the receivable because they arise from a different contract (ignoring those rights of an assignee of a receivable which arise from law and which may overlap with the IPU), but not all IPUs are necessarily "independent" from the receivable.

What does "independent" mean in relation to an IPU? (contd.)

- Based on our experience, market participants understand an "independent" IPU to be an IPU which is:
  - an irrevocable and unconditional undertaking from the Buyer to the Finance Provider;
  - to pay a confirmed amount (without any deduction, counterclaim, set-off or withholding) to the Finance Provider or its assigns;
  - on an agreed due date;
  - irrespective of whether (i) the associated receivable exists, (ii) the associated receivable is legally and/or beneficially owned by the Finance Provider or (iii) a competing claim from a third party has been made on the associated receivable; and
  - is freely transferable by the Finance Provider to a third party separately from the receivable.
- In summary, a debt obligation owed to the Finance Provider

What does "independent" mean in relation to an IPU? (contd.)

- Noting the criteria on the previous slide, consider the following:
  - Does the IPU refer to paying <u>the receivable</u> or does it refer to paying <u>a confirmed amount</u>?
    - If the former, the IPU appears to be dependent on the existence of the receivable and who owns it
    - It is unclear how a court might approach the validity of the IPU if the receivable was invalid for some reason
    - Also unclear whether a court would characterise the IPU as a debt (which prevents certain defences) or as an undertaking, breach of which would give rise to a damages claim
    - We do acknowledge though that most IPUs contain protective wording that the Buyer is to pay without any defences
  - Does the Buyer undertake to pay the amount to the owner of the receivable or does it undertake to pay the Finance Provider irrespective of whether it owns the receivable?
    - If the former, the person who benefits from the IPU appears to be dependent on who owns the receivable

What does "independent" mean in relation to an IPU? (contd.)

  - Does the Buyer undertake to pay the amount to a specified bank account held with the Finance Provider or to the Finance Provider for its own account?
    - If the former, is the IPU an obligation that is actually transferable by the Finance Provider?
    - It is unclear how a court might approach that question
  - Does the IPU contain very clear double-payment wording or is that implied only from the context?
- What is the Buyer's understanding of the effect of the IPU and its independence from the receivable?
  - An "independent" IPU creates double-payment risk for the Buyer. Does the Buyer understand that?
  - Has anything been discussed/agreed between the Buyer and the Finance Provider that contradicts the IPU?
- Are there additional rights for the Finance Provider outside of the IPU?
  - Representations, breach of which would give rise to a damages claim
  - Indemnities for losses suffered by the Finance Provider

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