SECURITIZATION OF FUTURE CASH FLOWS UNDER ENGLISH AND NEW YORK LAW

A COMMENT ON RAINES & WONG

DAVID M. EISENBERG*

For the practitioner, a future flow securitization presents interesting questions surrounding the choice of governing law. The principal objective of the transaction will be to reduce the political risk of lending to the originator in U.S. dollars or other hard currencies. Therefore, one would prefer to use New York or English law and jurisdiction, if practicable, to assure the international investor a predictable and orderly outcome if a dispute or default occurs. If the future flow asset consists of receivables arising from the export sales of the originator, the second option outlined in Marke Raines and Gabrielle Wong’s article is the preferable one. That is, New York law would govern the sale transaction with a submission to jurisdiction in New York and with an accompanying opinion that the choice of law and submission to jurisdiction is valid under both the law of New York and the law of the originator’s jurisdiction.

As Raines and Wong point out however, the application of New York law to the “sale” of the receivables raises its own set of problems. While it is unlikely that the originator would become subject to a full-blown U.S. bankruptcy proceeding, it could not be ruled out as the jurisdictional provisions of the U.S. Bankruptcy Code do not require much in the way of U.S. contacts to permit a U.S. bankruptcy

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* Partner in the law firm of Simpson Thacher & Bartlett, in the Firm’s Corporate Department where he concentrates on banking and corporate law and asset-backed securities transactions. Mr. Eisenberg is responsible for creating the asset-backed practice at the Firm.


2. Id. at 458.

3. This comment will focus on New York law since that is the sole qualification of its author. However, the author has no reason to believe that English law would be unsuitable.
filing. However, selecting local law to govern the transaction in any significant respect is at cross-purposes with the primary objective of the transaction.

I would argue that from an investor’s perspective the “true sale” issue is largely irrelevant. Since the assets do not exist at the date of the financing, the continued operation of the originator will be required to generate the assets in the future. This suggests that the insolvency of the originator is likely to leave the investor as an unsecured creditor. If the originator continues to operate and generate the assets, the structure of the transaction will force repayment of the securitization (i.e., the transaction is self-liquidating) even if there is a change in the originator’s willingness or ability to service the obligations. Such a change may be forced upon the originator, for example, by a change in local law or regulation that purports to restrict the originator from repaying hard currency external indebtedness.

Under these circumstances, and assuming a transaction structured in the manner described in the Raines and Wong article, the originator will be forced to attack the transaction in a U.S. or European court. The issue will not be whether the transaction is a “true sale,” but rather, whether the court will enforce the terms of the basic contracts. This will raise the choice of law question as well as other related legal principles.

Section 5-1401 of New York’s General Obligations Law, and its associated forum selection clause, strongly suggest that a U.S. court would enforce the contracts notwithstanding a change in local law or regulations, at least as long as the transaction had some contact or relationship to New York. Assuming such contacts, an originator

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4. See 11 U.S.C. §109(a) (1986) (requiring only that a debtor possess a place of business or property in the U.S. to support a bankruptcy filing); see also 11 U.S.C. § 304 (1986) (governing cases that are ancillary to a foreign proceeding), and 11 U.S.C. § 305 (1986) (empowering the Court to abstain from asserting jurisdiction).

5. The parties to any contract, agreement or undertaking, contingent or otherwise, in consideration of, or relating to any obligation arising out of a transaction covering in the aggregate not less than two hundred fifty thousand dollars, including a transaction otherwise covered by subsection one of section 1-105 of the uniform commercial code, may agree that the law of this state shall govern their rights and duties in whole or in part, whether or not such contract, agreement or undertaking bears a reasonable relation to this state . . . .

N.Y. GEN. OBLIG. L. § 5-1401 (McKinney 1988).

6. Id. § 5-1402(1).

would be forced to ask a U.S. court to abstain from enforcement based upon the so-called “act of state doctrine.” Under this doctrine, a U.S. court may consider as nonjusticiable, and confer presumptive validity on, the acts of a foreign state with respect to property located within its boundaries. Since the source of repayment for the securitization is, by definition, outside of the boundaries of the foreign state, it is unlikely that a U.S. court would abstain from enforcing the contracts on this basis. None of these issues depends on the outcome of the “true sale” question. It would not seem sensible as a general matter to trade the jurisdictional features of the transaction for a local law “true sale” opinion, nor would it seem sensible to trade the features described in the Raines and Wong article as being generally included in a future flow securitization that make the transaction seem more analogous to a secured loan, for a New York law “true sale” opinion.

There is one aspect of a future flow securitization for which a “true sale” analysis may be relevant. Many of the originators who engage in these transactions do so notwithstanding covenants in other indentures and loan agreements that prohibit the incurrence of secured indebtedness. It is difficult to generalize about such so-called negative pledge clauses because they are heavily negotiated and customized to the needs of the parties. However, such clauses seldom inhibit the sale of receivables. One analysis of a future flow receivables securitization that may be consistent with compliance with such a clause is suggested by Raines and Wong’s analysis of the effect of an assignment of future receivables under English law. This is not treated as a current assignment but rather as an agreement to assign. If so, then the obligations incurred in connection with the transaction may be interpreted as unsecured obligations of the originator that the originator has agreed to repay by delivering receivables when, and if, created. This would not seem to create a transaction “secured” by the receivables any more than a transaction in which the originator was paid in advance for the delivery of its product would create a transaction secured by inventory.
