

The value and problems of using an IPU (Irrevocable/ Independent Payment Undertaking) in Trade Receivables Transactions

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What today's presentation will cover

- What is an IPU?
- Analysis for Trade Finance
- Wording
- Bank Debt v Trade Debt
- Types of IPUs
- ePU
- BAFT version
- Platforms and ePUs
- MLETR
- Law Commission – Electronic Trade Documents Act
- Transferring digital IPUs
- Do IPUs work?
- Questions

What is an IPU?

- Irrevocable Payment Undertaking or Independent Payment Undertaking
- Could be either but
 - › for trade (ideally) just irrevocable
 - › if independent is it still trade debt?
- Different ways to achieve this
 - › promissory note/bill of exchange
 - › unconditional promise to pay a sum certain
- Apply this to trade
- Used to be used only in forfaiting

Nature of IPU

It is arguable that IPU should mean irrevocable payment undertakings, not independent payment undertakings

- IPU has limited usage (i.e. in relation to receivables arising under sale and services contracts and perhaps other commercial contracts). Their use is mainly for receivables finance transactions. They may also serve as security or quasi security in commodity self liquidating transactions for trade finance facilities. This would be wider than supply chain finance. IPU is not to replace promissory notes (**PNs**). A PN is an irrevocable promise to pay that is separate from but often connected to another transaction. An IPU is a promise to pay under a commercial transaction
- IPU = waiver of Buyer's rights (except defective goods claim which could be pursued separately): a promise to pay without withholding/deduction/set off/counterclaim. IPU is to remain classified as a trade debt, not a bank debt
- An IPU is a bankable undertaking but not a bank debt (which takes the payment obligation out of the purpose for which it was intended) since it is used to evidence and IPU arising out of the sale or service contract – therefore we seek to avoid any recharacterisation risk
- An IPU could be issued by a bank to replace the buyer's IPU

Delivery of IPUs

An IPU is a payment obligation given by the Buyer of goods and services to the Seller, and not by a third party (e.g. Guarantor) and not given to a third party (e.g. a financier). It should be fully assignable by the Seller

Specimen IPU

A typical **Specimen IPU Statement** *“Irrevocably agree to pay you the amount due under this contract/invoice, without any right to withhold payment, make deductions, or set off or counterclaim in respect of the amount due”*

Issues

Issues to be considered include (i) applicable law of the IPU; (ii) commerciality of having a Buyer sign IPUs; (iii) reclassification between trade debt and bank debt; and (iv) assignability of IPUs

Discussions surrounding the applicable law of IPU's

- The irrevocable nature of the payment obligation is dependent and should be specified in and follow the relevant commercial contract, therefore what may be needed is a separate set of rules or, at least, guidance for IPU's
- This also raises questions as to the enforceability of such undertaking (which is dependant upon applicable law) as it is up to the courts of each jurisdiction to take a view as to what type of instrument an IPU is as it is up to the relevant court to interpret the undertaking
- Options:
 - 1) The undertaking does not need to be a separate instrument. Ultimately what the Seller wants from the Buyer is for the Buyer to give a statement along the lines of: "I will irrevocably and unconditionally pay you this amount for the good/services". The Specimen IPU Statement could appear in an invoice acknowledgment or be built into the underlying contract. We are not trying to create an independent instrument, but to evidence what an IPU is. If it appears in a contract, it will be governed by the law of underlying contract
 - 2) When a Buyer gives the Specimen IPU Statement, this would mean that, whatever the applicable law is, the 'new rules' would provide that the Buyer will pay (and will not deduct anything (credit note, tax or otherwise) from the payment) — therefore an IPU can be seen as highly valuable in receivables financing since it improves the bankability of such receivables
- What if the Buyer does not pay under the IPU, under which law would we examine the Buyer's liability? If you do not specify a law to govern the IPU, the assumption is that the IPU will follow the law of the underlying contract

Discussions surrounding the commerciality of IPU

- If the Buyer provides the Specimen IPU Statement, this would mean that they are giving up the rights they would otherwise have. This raises questions as to the commercial viability of the IPU (e.g. would a Buyer be prepared to give this statement, especially without financing?)
- Arguments:
 - › An IPU does not seek to prevent the Buyer from utilizing its rights to claim against the Seller for defective goods, but it does give up the right to withhold payment of an invoice
 - › A Specimen IPU Statement from the Buyer will be commercially challenging, but if the Buyer understands the bankability of such statement, it may be interested

Discussions surrounding the reclassification of IPUs from trade debt to bank debt

If the Specimen IPU Statement is given to the financier, then there is a risk of reclassification from trade debt to bank debt

- The Specimen IPU Statement should be given to the Seller
 - › An IPU is given to the Seller. The Seller can then use this characteristic of the trade debt, and the assignability of it in a financing
 - › On this basis, the Buyer would see that if they give the Specimen IPU Statement to the Seller, the debt will remain trade debt
- Would the characteristic change if a financier intervenes?
 - › This is something to be addressed. We can deal with the question as to whether trade debt transforms into bank debt if the Specimen IPU Statement is given to or held by the financier. The manner of documenting the arrangement could seek to influence the basis on which the IPU could remain as trade debt
- Assignability should solve the issue of not needing to provide the IPU directly to the financier

Bank Debt v Trade Debt

- Much argument over the years on this subject
- Initially raised by Ratings Agencies
 - › are parties misled by terminology
 - › are accounts misleading?
- Driven by failure in the payables space
 - › one party's receivable is another's payable
 - › so if it is payable to a bank it must be bank debt!!
 - that cannot be right!
- These points are being taken up by proposed changes to accounting standards – IAS and IFRS

Proposed amendments to IAS and IFRS

- The suggested changes to IAS and IFRS aimed to enable users of financial statements to better assess the effects of Supply Finance Arrangements (SFAs) on the buyer's liabilities and cash flows, as well on its liquidity risk and risk management
- The buyer will commonly record an arrangement where the supplier is comfortable with exposure to the credit risk of the buyer and the buyer commonly records this obligation as an Account payable or a Trade payable on the balance sheet
- The IAS noted in the Exposure Draft the proposed amendments will affect
 - › the buyer as they are the entity entering into the SFA and
 - › the bank/financer as it imposes further reporting requirements as the bank purchases the buyer approved invoices from the supplier and through which the buyer settles its accounts payable in the SFAs
- In principle some agree with the proposed transparency however, in relation to the specific requirements on disclosure that are proposed by way of amendments to the IAS and IFRS the view seems to be that these changes will (i) create a number of negatives for the parties in the transaction with limited benefit and (ii) that they are of limited use

Disclosure objective and disclosure requirements

- Paragraph 44F of the Amendments to IAS 7 would require an entity to disclose information in the notes about SFAs that enables users of financial statements to assess the effects of those arrangements on an entity's liabilities and cash flows
- To meet that objective paragraph 44H of the Amendments to IAS 7 proposes to require an entity to disclose:
 - › Terms and conditions of each agreement
 - › For each agreement, as at the beginning and end of the reporting period:
 - the carrying amount of financial liabilities recognized in the entity's statement of financial position that are part of the arrangements and the line item in which those financial liabilities are presented
 - the carrying amount of financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers; and
 - the range of payment due dates of financial liabilities disclosed under (i) and
 - › As at the beginning and end of the reporting period, the range of payment due dates of trade payables that are not part of a supplier finance arrangement

Disclosure objective and disclosure requirements

- 44H(a): This requirement is not necessarily practical or makes sense especially if the buyer is not a party to the financing agreement between the bank and the supplier. However the buyer may not always be in a position to disclose the terms and conditions of the financial arrangements
- 44H(b)(i) is only possible provided that the financial liabilities are defined as the amount of the payable obligations to the suppliers outstanding as of the reporting period for which the buyer has appointed the financial services provider as paying agent. It is not possible if the intention is to target the amounts actually financed by the finance provider
- Further in terms of 44H there is a question as to whether it is feasible for the financier to disclose this requirements without reaching any other confidentiality requirements. For example Deloitte considers that this change will provide limited useful information given the short nature of the amounts that are typically subject to the supplier
- For a financing to be considered a payables financing program it must fit into certain parameters
 - › Generally this means that tenors do not exceed 180 days.
 - › Payment terms are subject to negotiation between the trading parties.

Bank Payment Undertaking (BPU)

Definition

A Bank Payment Undertaking (BPU) is provided under a **buyer-led programme** within which sellers in the Buyer's supply chain receive an independent and irrevocable payment undertaking from the Buyer's Bank to pay the accepted invoice(s) (or the Buyer's approved amounts relating to such invoice(s)) on the due date. The Buyer's Bank becomes the primary obligor to make the payment to sellers. Such payment to a Seller covers Seller's invoices (or buyer approved amounts relating to such invoices) resulting from trade transactions

A BPU features:

- an independent and irrevocable payment undertaking by the Buyer's Bank
- issued on the back of the Buyer's payment instruction for their trade payables and their commitment to the Buyer's Bank to pay accepted invoice(s) (or the Buyer's approved amounts relating to such invoice(s)) on the due date
- allows a Seller to substitute the Buyer's payment risk with that of the Buyer's Bank

Why use the BPU?

- The technique also provides a seller of goods or services (Seller) with the option of receiving early payment of outstanding invoices (that have an unconditional approval by the buyer to pay on the due date) prior to their actual due date and typically at a discount from the Buyer's Bank
- Unlike in a Payables Finance programme, a BPU programme does not require any receivables purchase arrangements between the Buyer's Bank and the Seller but may require the Seller to confirm the Buyer's Bank's right to receive Buyer payment and/or acceptance of early payment as full payment of the approved invoice amount
- The issuance of BPU transfers the original payment obligation to the Seller from the Buyer to the Buyer's Bank. The BPU is a primary obligation, which when issued discharges the underlying invoice(s); and only upon payment (or early payment at discount) to the Seller is the Buyer's Bank discharged from its BPU obligation
- A Seller, can alternatively arrange to receive such early payments with other finance providers (Seller's Bank) with cost of early payment more aligned to the credit risk of the Buyer's Bank under assignment of the BPU or similar mutually agreed terms and conditions

Use of BPUs in Structuring Receivables and Payables Financing

- Usually arranged between Buyer and its Bank
- Relies on Buyer approving the invoice
- Buyer can then encourage Seller to use BPU
- Seller gets BPU
- Seller can request early payment of BPU from Buyer's Bank or another Bank at a discount
- Good structuring options
- Need to monitor risks like double funding
- Note accounting treatment

The Electronic Payment Undertaking (ePU)

- Part of ITFA's Digital Negotiable Instruments Initiative which launched in September 2019
- ePU has been launched with much discussion
- Part of a phased approach towards ITFA's aim of fully digital instruments
- A digital equivalent of the bill of exchange and promissory note
- Delivers a digitally neutral irrevocable, unconditional and independent payment undertaking
- Fulfils all requirements of a traditional negotiable instrument, subject to contract law

How to cope with the digital issues

- Technology moves faster than legal changes
- English law can be flexible to a point as legal decisions often move the position forward - but not always, as electronic bills of exchange demonstrate
- Other jurisdictions have tried in some areas, Singapore and US as examples
- What other solutions work?
- Use terms and conditions for members to sign up to
- Have contracts using the terms agreed by members

What platforms are offering – Contractual Solution

- Marco Polo as an example
 - › A legal framework for the creation of payment obligations in respect of digital supply chain solutions
 - › Rules to govern the legal relationship between buyer and seller in respect of a payment obligation (The Rulebook)
 - › Ease of transferability of the payment obligation
 - › Full integration of URDTT
 - › Secure data matching to authenticate the transaction data

BAFT Distributed Ledger Payment Commitment (DLPC)

- A digital asset and global standard for a payment commitment
- Governed by Delaware law
- 2 key reference documents: DLPC Business Best Practices and DLPC Technical Best Practices
- Purported benefits of DLPC include:
 - › reducing risk;
 - › speeding up processing;
 - › accelerated automation;
 - › process simplification and interoperability
- But, benefits vs Delaware law? A fundamental point for consideration

UNCITRAL – Model law on Electronic Transferable Records (2017) (MLETR)

- MLETR has been said to breathe life as Singapore, Bahrain, Abu Dhabi Capital Markets and, recently, Belize show
- “Electronic record” means information generated, communicated, received or stored by electronic means, including, where appropriate, all information logically associated with or otherwise linked together so as to become part of the record, whether generated contemporaneously or not – very broad definition
- Does not apply to securities, such as shares and bonds, and other investment instruments, as well as any other types of instrument that can be specified by enacting bodies
- Law Commission of England & Wales is not considering MLETR as the initial solution

MLETR (Continued)

- Signature - *Where the law requires or permits a signature of a person, that requirement is met by an electronic transferable record if a reliable method is used to identify that person and to indicate that person's intention in respect of the information contained in the electronic transferable record.*
- This is a lower standard than an AES or QES under UK and EU eIDAS and so an electronic signature valid under MLETR may not meet the criteria of an AES/QES
- Does not address inherent issues (e.g. possession)
- Therefore, it does not provide a complete solution but is a step in the right direction

Law Commission on digital trade

- Focussing on removing the key blocker to electronic trade documents in English law by effectively recommending a new definition of “possession” in relation to intangible trade documents so that these can also be “possessed” as part of an electronic system or platform
- What is key is the need for “exclusive control”, divestibility and independence of the document
- Its draft Electronic Trade Documents Bill is very short and focusses on the issue of possession and control in this specific context to remove this blocker and provide protection and recognition of electronic trade documents under English law. Legislation be passed this year or early 2023 by Parliament to make any amendment to English law

ITFA and transferable electronic payment obligations

- Working with ITFA on Uniform Rules for this (URTEPO)
- Aimed to be launched in September
- Designed to provide rules on rights and obligations of parties where a digital payment obligation is to be transferred
- Neutral as to how a payment obligation is created other than it is to be digital
- Neutral as to medium used to “register” transfer
- Sets out timings for inspection of records
- Sets out rights and obligations of sellers and buyers of the TEPO
- The way forward? We shall see

Do IPUs work?

- Paper and digital options
- They have a “strong” place in expanding supply chain options
- Explain these advantages to those who “oppose”
 - › Ratings Agencies
 - › Auditors
- Explain to Regulators to make trade finance assets more “acceptable” for banks and financial institutions
- What about making them investible for non-banks?
 - › ITFA initiative

ITFA's Whitepaper on making Trade an Investible Asset Class

- Launched May 2022
- Makes proposals on
 - › Uniform principles
 - › Digital infrastructure
 - › Legal framework
 - › Proposed market survey
- Aimed at assisting non banks investors to invest in this class of asset
- Need to define what the class is
- Assist in risk transfer
- Looks at the role of technology-the way forward?
- Can this and does this fit with the IPU?

Any Questions?

Geoffrey Wynne

Partner

Geoffrey Wynne is head of Sullivan & Worcester's London office and also head of its Trade & Export Finance Group. He has extensive experience in banking and finance, specifically trade and structured trade and commodity finance. He also advises on corporate and international finance, asset and project finance, syndicated lending, equipment leasing and workouts and financing restructuring.

Geoff is one of the leading trade finance lawyers and has advised extensively many of the major trade finance banks, multilateral financiers and companies around the world on trade and commodity transactions in virtually every emerging market including CIS, Far East, India, Africa and Latin America. He has worked on many structured trade transactions covering such diverse commodities as oil, nickel, steel, tobacco, cocoa and coffee. He has worked on warehouse financings in many jurisdictions and advised on how to structure involving warehouse operators and collateral managers. He has also advised on ownership structures and repos for commodities and receivables financings.

Geoff sits on the editorial boards of a number of publications and is a regular contributor and speaker at conferences. He is also the editor of and contributor to *The Practitioner's Guide to Trade and Commodity Finance* published by Sweet & Maxwell and *A Guide to Receivables Finance*, a special report from TFR published by Ark.

Geoff has been recognized as the only UK lawyer included in the Trade Finance section of the *UK Legal 500's* all new UK '**Hall of Fame.**' *Trade & Forfeiting Review* (TFR) honoured Geoff with the TFR Fellowship Award in its 2017 TFR Excellence Awards.

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Awards & Recognition

Chambers UK, 2022

Chambers UK, 2022 ranked Sullivan in Commodities: Trade Finance (UK-wide) Geoffrey Wynne and Simon Cook are Ranked Lawyers in Tier 1 and Tier 2 respectively Sam Fowler-Holmes is recognised as an “Up and Coming” lawyer

The Legal 500 UK, 2022

Sullivan ranked in Tier 1 for Trade Finance by *The Legal 500 UK, 2022* for the eighth year running Partner Geoffrey Wynne is included as a Leading Individual for Trade Finance in the “Hall of Fame” Simon Cook and Mark Norris are recognised as Leading Individuals Sam Fowler-Holmes is recognised as a Next Generation Partner and Hannah Fearn as a Rising Star

IFLR1000 Banking and Finance Guide, 2022

Sullivan recognised for Banking Lending - Lender Side, United Kingdom, in *IFLR1000's Banking and Finance Guide, 2022* Partner Geoffrey Wynne is ranked as a Leading Lawyer in the United Kingdom

Global Trade Review (GTR) “Best Trade or Supply Chain Finance Law Firm”, 2022

GTR named Sullivan “Best Trade or Supply Chain Finance Law Firm” at the GTR Leaders in Trade Awards in 2022

Trade Finance Global “Best Trade Finance Law Firm” 2022

Sullivan named “Best Trade Finance Law Firm” 2022 by *Trade Finance Global* (in connection with BAFT) at its International Trade Awards, 2022

In 2021, 2020 and 2019, GTR named Sullivan

The “Law Firm of the Year” in the category “Leaders in Trade for Innovation” at the 2021 GTR Leaders in Trade Awards and “Best Trade Finance Law Firm” at the GTR Leaders in Trade Awards in 2020 and 2019

2021 Lexology “Client Choice” award for Banking, United Kingdom

Geoffrey Wynne named a recipient of the Lexology “Client Choice” Award 2021 for Banking, United Kingdom

Trade Finance Global “Best Trade Finance Law Firm” 2019

Sullivan named “Best Trade Finance Law Firm” 2019 by *Trade Finance Global* at its International Trade Finance Awards, 2019





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