Feature

KEY POINTS

- Companies contracting under English law do not enjoy the same freedom to assign receivables as companies contracting under New York law or French law.
- The Regulations are a limited example of a justifiable statutory interference with the principle of freedom of contract under English law.
- Any legitimate concerns should be dealt with by an alteration in the drafting of the Regulations or through other solutions rather than by abandoning the Regulations entirely.

Authors Dimitrios Logizidis and Alexander Tompkins

Interference with freedom or freedom through interference? The proposed regulations that would render "ban on assignment" clauses ineffective

This article recaps the history of the regulations that were published in draft form as the Business Contract Terms (Assignment of Receivables) Regulations 2017 (the Regulations) and subsequently withdrawn in late March 2017, that would, if re-introduced, be made under s 1 of the Small Business, Enterprise and Employment Act 2015 (the Act). It seeks to place the Regulations in their proper context internationally and to assess legal arguments as to how the Regulations affect the principle of freedom of contract under English law.

INTRODUCTION

The assignment of receivables is an important legal mechanism underpinning asset backed financing structures that are routinely implemented by many different types of company. For smaller companies and those in certain industries, receivables can constitute a key asset of the company and therefore a vital route of accessing finance. For larger corporates, the off-balance sheet nature of financing received as part of a receivables sales programme is often an attraction. Some of the world's very largest companies routinely assign receivables to generate finance.

English law does not facilitate the sale of receivables in the same way that New York law or French law does. Most receivables sales programmes will stop a supplier assigning a receivable arising under an English law governed contract entered into with their buyer counterparty that contains a clause restricting the ability of the supplier to assign the receivable arising under such contract (a "ban on assignment" clause). Based on the current law, it is accepted that an assignment of a receivable in breach of a "ban on assignment" clause cannot be a statutory assignment under s 136 of the Law of Property Act 1925 unless the consent of the buyer is obtained.[1] It is a matter of debate and dependent on the wording of the "ban on assignment" clause as to the nature of the equitable title to the receivable and/or beneficial interest arising from a trust over the receivable that the assignee would obtain. Although the assignee may be entitled to the collections received by the supplier as a matter of contract and express or constructive trust, there is not sufficient comfort under English law for most receivables financiers that an assignment of a receivable in breach of a "ban on assignment" clause is enforceable against third party creditors and against an insolvency official of the supplier. On a practical level, the assignee of a receivable assigned in breach of a "ban on assignment" clause cannot compel the buyer of the goods to redirect payments due under the contract to the assignee.[2] Even in the largest securitisation programmes in existence, "ban on assignment" clauses often restrict companies from assigning English law governed receivables.

THE REGULATIONS

Efforts to address this issue date back to 2005 with the publication of a Law Commission report recommending legislation to override "ban on assignment" clauses.[3] The first draft regulations were published in 2014. Following the passage of the Act in 2015 and government consultations, the revised Regulations were published in September 2017. The reaction was very mixed. Some, including financial officers in companies and those working professionally in the receivables financing market, welcomed the Regulations, anticipating the opportunities that could be seized such as the conservative estimate of £833m of extra receivables financing per year that the government and the Asset Backed Finance Association estimated could be unlocked.[4]

Others were concerned by the potential impact of the Regulations, with particular objections raised by those in the projects and construction field. Some lawyers argued that the Regulations should be rejected out of hand as an unusual legislative measure that constituted an unjustifiable interference with the key English law principle of freedom of contract. Whilst it is not claimed that the Regulations are without flaws, it is this final objection that is reviewed in this article. Following the criticism, the Regulations were eventually withdrawn in late November 2017.

ENGLISH LAW AS A LAW OF CHOICE INTERNATIONALLY

English law is widely chosen by commercial parties as the governing law of their contracts based, at least partly, on the ability of parties to agree the terms that will govern their contractual relationship. However, in the international context, financial officers

assessing receivables financing opportunities can be disappointed to see English law governing a large part of their portfolio of receivables. For an English company selling goods under contracts governed by English law, New York law, French law and German law, only English law does not contain any provision that will facilitate the company assigning the receivable arising under these contracts.

In particular, the provisions of Art 9 of the Uniform Commercial Code (UCC) are incorporated into New York law (and the laws of certain other States) and are commonly relied upon to render "ban on assignment" clauses ineffective. Under French law, the provisions of Art L. 442-6 II of the French Commercial Code generally render "ban on assignment" clauses null and void. In addition to these prominent jurisdictions, international standards such as the 1988 UNIDROIT Convention on International Factoring and the 2001 UN Convention on the Assignment of Receivables in International Trade have each sought to remove the effectiveness of "ban on assignment" clauses.[5]

It is therefore wrong to characterise the Act and the proposed Regulations as unusual legislative measures, particularly in view of the inclusion of Art 9 of the UCC in New York law, the other governing law often chosen by commercial parties internationally. However, given the primary importance to English law of the freedom of parties to agree their contractual terms of contract, it is worth considering whether the Regulations present an unjustifiable interference with this freedom.

FREEDOM OF CONTRACT

There are instances in English law where statute or common law interfere with the ability of commercial parties to agree the terms of their contractual relationship. Outside of consumer law, the most relevant examples would be implied terms under the Sale of Goods Act 1979, statutory interest under the Late Payment of Commercial Debts (Interest) Act 1998, the unenforceability of certain contractual "agreements to agree" and the rule against contractual terms that are deemed to be penalties. However, it is true that English legislators and judges have tended to avoid making law that renders contractually agreed terms ineffective, choosing instead to uphold the intention of the parties.

What is the intention of the parties including ban on assignment clauses in their contracts?

In many cases, a "ban on assignment" clause is a standard term included in a contract between a supplier and a buyer. Whilst the wording of each clause will produce different consequences, in general, buyers want to ensure that the supplier is the exact legal entity that will perform its *obligations* towards the buyer under the contract.[6] However, this aim is not achieved by including a "ban on assignment" clause in most formats. Those working in the receivables finance market will be familiar with "ban on assignment" clauses that are worded in a way that clearly displays this intention.[7]

An assignment under English law can only be utilised to transfer the benefit of a contract and not the burden so that it is possible to assign the right to receive payment but it is not possible to assign the obligation to supply goods or services. In order to effect a change in the entity that will be liable towards the buyer it would be necessary under English law to effect a novation of the contract, usually by executing a deed of novation. A "ban on assignment" clause is not relevant in this context; the buyer can simply refuse to agree to sign a deed of novation effecting a change in supplier under the contract.

Another way for a supplier to delegate the performance of its obligations to another legal entity is by entering into a subcontracting arrangement with another entity. If the contract between the supplier and the buyer contains a clause prohibiting the supplier from subcontracting, then the supplier will be in breach of contract if it enters into a subcontracting arrangement. However, in any subcontracting arrangement it will be the supplier that will remain liable towards the buyer for performance.[8]

If the intention of the parties is indeed to control the identity of their counterparty, most "ban on assignment" clauses are therefore not reflective of the true intention of the parties and are in fact mistakenly included in contracts by parties that believe that they achieve a different result. Some critics have muddied these waters by claiming that the Regulations could prevent buyers from justifiably ensuring that their supplier counterparties remain liable to them for performance of the contract.

How do the Regulations interfere with the intention of the parties?

The Regulations render a clause ineffective "to the extent that it prohibits the assignment of a receivable arising under that contract or any other contract …".

If it is accepted that in most cases the intention of the buyer is to control the identity of their supplier counterparty, the Regulations should not affect the intention of the parties. To the extent that a contractual clause restricts the ability of the supplier to subcontract, this clause should not be affected by the Regulations. This should remain the case if the ban on subcontracting is included within the same clause as the "ban on assignment" clause. But what if the buyer does intend to stop the supplier from assigning its receivable?

What if parties really do intend that the supplier should not assign its receivable?

It is possible that a buyer would want to include a "ban on assignment" clause in its contract with its supplier for other reasons. The buyer may not want to be contacted by an assignee or have to undertake the administrative burden of redirecting its payment. There is some evidence that buyers may consider that an assignee may be more efficient and persistent in demanding payment than its supplier counterparty.[9]

It is true that the Regulations do restrict the freedom to contract on this specific basis. It should, however, be noted that:

- the buyer has contractually agreed as an express condition in the contract to pay the price for the goods or services received; and

Feature

Biog box
Dimitrios Logizidis is a partner and Alexander Tompkins is an associate in the Securitisation and Structured Finance practice at Gide Loyrette Nouel in London.
Email: logizidis@gide.com and tompkins@gide.com

- the assignee only has the same claim against the buyer as the supplier does, such that the assignee will take the receivable subject to trade disputes and claims by the buyer against the supplier (provided that any such claims have arisen prior to the service of a notice of assignment by the assignee to the buyer).

However, there is a good argument that the supplier's assignment of its receivable should not materially increase the amount payable by the buyer under the contract. Critics of the Regulations have raised two concerns in this respect. First, that tax law or sanctions could result in gross up costs or fines for the buyer. Second, that the buyer could be prejudiced by the loss of mutuality of claims between the supplier and the buyer with respect to the assignment of the receivable arising under the contract resulting in the buyer losing its right to set-off with respect to sums that it owes to the supplier under the assigned claim.

Potential solutions

One solution for the first issue (and to a limited extent the second issue) would be for the buyer to include new clauses in their contracts with suppliers requiring indemnification from the supplier in the event that the buyer incurs any increased cost as a result of the assignment by the supplier of the receivable arising under the contract. The Regulations would not prohibit this. In a similar vein, the government could include a new Regulation in the Regulations clarifying that the buyer will not, under any circumstances, be required to pay more with respect to an assigned receivable then the buyer would have needed to pay to the supplier.

Regarding the potential loss of mutuality of claims for set-off purposes, this should not be an issue in most contractual relationships underlying trade receivables. Assuming that an invoice is issued after delivery of the goods or provision of the services, the receivable would arise following such delivery or provision and therefore at the time the receivable is assigned any quality or trade claim will have arisen (ie necessarily prior to the delivery of a notice of assignment).

In any case, it is accepted that it is possible for the buyer to be prejudiced in more complex contractual relationships by the loss of mutuality of claims for set-off purposes. This is a public policy decision to be taken by the government as to whether the "cost" of potentially prejudicing the buyer in this way is worth the "benefit" of the Regulations.[10] For more complex contractual relationships, such as construction projects there may be other issues to be considered.[11]

A compromise solution could be to provide that outside of the context of trade receivables (ie simple contracts for the sales of goods or provision of services) and strictly for those contracts that contain "ban on assignment" clauses rendered ineffective by the Regulations, the buyer would retain the ability to set-off claims that arise against the supplier after the delivery of a notice of assignment to the buyer from the assignee. This would be a proportionate and amended form of a solution proposed by the City of London Law Society.[12]

CONCLUSION

Whilst the Regulations would interfere with the freedom of the parties to contract on their precise terms, this is justifiable when the usual intention of the parties in including "ban on assignment" clauses in their contracts is considered in detail. There is potential for some prejudice to the buyer under the Regulations in relation to its ability to set-off in certain circumstances which could be addressed in revised Regulations or by a change in contractual practice by buyers to include new clauses. ■

1 *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] AC 85 (HL).
2 *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] AC 85 (HL).
3 The Law Commission, *Company Security Interests (LAW COM No 296)*, August 2005.
4 Department for Business, Energy and Industrial Strategy, *Impact Assessment: Measure to nullify ban on assignment clauses in a debtor's terms of sale*, 13 September 2017, para 104.
5 These conventions were not widely signed or ratified but indicate a level of support for the argument against "ban on assignment" clauses.
6 Department for Business, Energy and Industrial Strategy, *Impact Assessment: Measure to nullify ban on assignment clauses in a debtor's terms of sale*, 13 September 2017, para 19 and Beale, Gullifer and Paterson, *A case for interfering with freedom of contract? An empirically-informed study of bans on assignment*, p 17 and p 21.
7 Common clause formulations restrict the ability of the supplier to "… assign the contract …", "… assign the rights and obligations under the contract …", "… assign the contract or any part thereof …" and "… assign its rights or obligations under the contract".
8 *Tweddle v Atkinson* [1861] EWHC QB J57, as applied by the House of Lords in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] UKHL 1.
9 Beale, Gullifer and Paterson, *A case for interfering with freedom of contract? An empirically-informed study of bans on assignment*, p 18.
10 The public policy aim of the Government in this respect is similar to the aim advanced under the Late Payment of Commercial Debts (Interest) Act 1998.
11 However, even in the context of project and construction contracts the issue is usually overstated. For instance it is not practical to suggest that the controllers of a bankruptcy remote project company that is owed receivables under certain project contracts and is contractually restricted from assigning such receivables would take the decision to assign such receivables given its contractual restrictions under its financing arrangements with the project lenders.
12 City of London Law Society, *The Business Contract Terms (Assignment of Receivables) Regulations 2017*, 20 November 2017.

Further Reading:

- Ban on assignment clauses: views from the coalface (2015) 8 JIBFL 463.
- Ban the ban: prohibiting restrictions on the assignment of receivables (2015) 3 JIBFL 136.
- LexisNexis Loan Ranger blog: Business Contract Terms (Assignment of Receivables) Regulations 2017: Unexpected consequences for lenders.