

Bans on Assignment

WHAT IS A BAN ON ASSIGNMENT?

Receivables financiers rely on the ability to:

- in the case of way of whole turnover receivables purchase (RP) facilities, take an absolute assignment, with no equity of redemption, over receivables such that there is an outright disposal of the receivable from the seller to the financier; and
- in the case of secured borrowing base (BB) facilities, take security (typically an absolute assignment by way of security) over the receivables.

A ban on assignment is a prohibition contained in a contract of sale or supply (Contract) between a customer and its debtor restricting one or both parties from assigning (whether by way of outright disposal or by way of security) certain or all of their rights (including any rights to receivables) under that Contract.

EFFECT OF BAN ON ASSIGNMENT PROVISION

Whilst there is considerable academic debate on what the effect of a ban on assignment provision should be under English law, the current English law position is that if a contract contains a clearly drafted ban on assignment provision, an assignment in breach of such ban will be ineffective in transferring the receivable (but not the proceeds) to the assignee (see *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Limited* [1993]) unless the Regulations (as defined below) apply.

Assuming that the Regulations do not apply to the parties and contract in question, the debtor may disregard any notice of assignment given to it by a financier and continue to make payment to the customer to obtain good discharge of the receivable. Its rights of set-off will also not be affected (see *Helstan Securities Ltd v Hertfordshire County Council Ltd*).

THE BUSINESS CONTRACT TERMS (ASSIGNMENT OF RECEIVABLES) REGULATIONS 2018 (THE REGULATIONS)

The Regulations, which came into force on 24 November 2018, are intended to make it easier for small and medium sized enterprises to access receivables-based finance by making ineffective any prohibitions, conditions and restrictions on the assignment of receivables arising under a Contract.

Consequently, not only do the Regulations render ban on assignment provisions as ineffective, but their scope also extends to related clauses, such as confidentiality clauses, to the extent such clauses prevent the assignment of a receivable.

Unfortunately, a financier cannot solely rely on the Regulations without further diligence at the time the receivable is assigned. This is because the Regulations contain certain exclusions, notably:

- The Regulations only apply to contracts entered into on or after 31 December 2018.
- The Regulations do not apply if the supplier under the contract is a large enterprise (assessed, in the case of companies, on its turnover, balance sheet and/or number of employees by reference to its most recent annual accounts), or a member of a large group, at the time of assignment.
- The Regulations do not apply if the supplier is a special purpose vehicle (a firm with the primary purpose of holding assets (other than trading stock) or financing commercial transactions, which in either case involves it incurring a liability under an agreement of £10 million or more) at the time of assignment.
- The Regulations do not apply to a contract where none of the parties to the contract have entered into it in the course of carrying on a business in the United Kingdom.

WHAT OPTIONS DOES A FINANCIER HAVE WHEN PRESENTED WITH A CONTRACT WITH A BAN ON ASSIGNMENT CLAUSE AND WHERE THE REGULATIONS DO NOT APPLY?

A financier's options depend on whether the transaction is structured as a RP facility or a BB facility. In both cases, a financier may consider asking the customer to:

- (a) vary the Contract to remove the ban; or
- (b) obtain a waiver from the debtor.

In many transactions, the above options will not be viable, particularly where the transactions are confidential. In those circumstances, in order to avoid receivables from being ineligible for financing, a financier may consider one of the alternative options described below.

Declaration of Trust

A Contract that prohibits assignment will not, in the absence of clear drafting to the contrary, prohibit the creation of a trust over the receivable (see *Don King Productions Inc v Warren* [2000]).

In a RP facility, a financier can request that the seller declares a trust in respect of any receivables that fail to assign by way of outright disposal to the financier. Whilst this does not create a direct relationship with the debtor, it should result in transferring to the financier the seller's beneficial interest in the receivables and their proceeds.

A declaration of trust in a RP facility will typically be supplemented with a power of attorney from the seller appointing the financier as attorney to do anything necessary to preserve and/or perfect the financier's title to the receivables or to collect the receivables. As powers of attorney can only be granted pursuant to a deed, RP facility agreements are executed as deeds by the parties.

For a BB facility, the declaration of a trust is a less useful option because the trust is not a form of security interest.

Take a Charge

A Contract that prohibits assignments may not, depending on the wording of the restriction, prohibit the creation of a charge or other security interest over the receivable.

Accordingly, a financier could, in the case of a BB facility, obtain a charge over the receivables from the borrower. As there are minimal practical differences from a financier's perspective between a fixed charge and an assignment by way of security, this is a useful workaround.

In the case of a RP facility, a financier will seek to obtain a charge over any receivables affected by a ban on assignment or trust (commonly called a non-vesting receivable).

WHAT IF ASSIGNMENTS, CHARGES AND TRUSTS ARE ALL PROHIBITED?

Whilst unusual, if a Contract contains a prohibition against an assignment of, the granting of security over, and the declaration of a trust in respect of, receivables, a financier should have a cause for concern. Receivables arising from any such Contract should not be financed unless the Contract is amended or the provision waived.

WHAT IF THE CONTRACT IS SILENT?

If the Contract is silent on assignment, or the grant of security then, other than for personal contracts (contracts where the rights are so personal to the parties that the rights are not capable of being assigned), the receivable may be assigned or security may be granted over it without requiring the consent of the debtor and without restriction.

If the Contract is silent on the grant of a declaration, a trust can be declared over the receivable without requiring the consent of the debtor and without restriction.