Nullification of anti-assignment clauses - good news for invoice financers and their customers

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Currently, a clause in a contract which prevents one or both parties from assigning its rights under that contract is effective under English law. Such prohibitions on assignment are common in many types of contract.

While this has not inhibited the growth of an active invoice finance market in the UK, it has necessitated waivers and workarounds (such as trust account arrangements) to allow the market to function.

What’s changing?

The UK Government proposes to make a change to the law so that a clause in an agreement which prohibits the assignment of a receivable will have no effect under English law. The nullification provision will only apply to the extent that the clause prohibits assignment of a receivable. A blanket prohibition on assigning any interest in the contract would therefore not prevent the assigning of a receivable, but would continue to prevent assignment of another right.

The government intends for the nullification provision to apply to business to business contracts governed by English law where at least one of the parties carries on business in the UK.

The nullification provision will not apply to:

- Financial services contracts (which is broadly defined but will include, among other things: lending contracts, guarantees, derivatives contracts, insurance contracts, and finance leases);
- Contracts relating to interests in land;
- Consumer contracts; and
- Contracts entered into before the regulations introducing the nullification provision come into force (i.e. the change will not apply retrospectively).

When is this happening?

The government has indicated that it intends to progress the regulations required to implement the change in Autumn 2015, with a view to the changes coming into effect in early 2016.

The upsides

For invoice financers, the main upside will be an increase in control. Following the change, it will be possible for
invoice financers to take a legal assignment irrespective of any prohibition in the underlying contract. Assuming the new regulations do not interfere with the current position on resolution of disputes, invoice financers will therefore, if they choose to, be able to sue in their own right to recover the assigned debts without any need to involve the assignor.

Small and medium sized business are, or at least were initially, the intended beneficiaries of the change. There was discussion of only extending the nullification provision to contracts with SMEs, but this has been rejected.

Currently, smaller businesses can find it difficult to access invoice financing, due to an unwillingness on the part of some invoice financers to take a risk using a workaround such as a trust arrangement where the customer may not have a strong financial position. The greater flexibility to use a legal assignment in all cases, may open up the invoice finance market to SMEs, and make them a more attractive customer base for invoice financers.

In addition, as debts will become freely assignable, this will assist the securitisation of receivables, releasing additional funding into the invoice finance sector.

The downsides

Concerns have been raised as to how the nullification provision will impact on the rights of debtors. Under the current law debtors can avoid any potentially adverse consequences of the invoices they owe being assigned by including an anti-assignment clause in their contracts.

During consultation, the government sought views on whether there should be provision to protect debtors from losses suffered due to the assignment. It appears, from the government’s response to the consultation, that it does not intend to include such a provision in the new regulations.

There are also no plans to deal with set-off rights in the new regulations. Under the current law, an assignment could, after notice to the debtor, limit a debtor’s right to set off amounts owing to it (for example, a liability owed by the supplier under a separate contract) against the debts owed to its supplier. While assignment could cause issues for debtors in this regard, contractual set-off terms may still preserve set-off rights post-assignment.

Debtors have also voiced concern about how disputes will be dealt with once the invoice is assigned. Who will the debtor deal with if an assigned invoice is disputed? The government has expressed its view that disputes in relation to invoices should continue to be dealt with between the debtor and the assignor even after the invoice had been assigned. It is unclear how the government proposes to proceed in this regard as its consultation response does not expressly cover this issue.

A slight downside for invoice financers and their customers is that, due to the retention of debtors’ rights to sue the supplier for any breach of confidentiality restrictions which is made in the process of the assignment, they are unlikely to be able to ignore the terms of the underlying contract altogether. A due diligence exercise is still likely to be necessary, at least to check for confidentiality arrangements.

Unanswered questions

There are still questions to be answered as to how exactly the nullification provision will operate. We await with interest the details which will be provided when regulations to implement the proposals are published.