

Non-assignment clauses and their treatment under UNCITRAL's Secured Transactions Law instruments

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Introduction

Receivables financing is an important method of raising finance. Raising finance through assignment of receivables 'is simply bigger business than the financing of mobile goods.'¹ Receivables financing has seen considerable growth as 'receivables are self-liquidating and ... an excellent short-term source of cash.'² Particularly, small businesses routinely use their receivables to finance their operations. Unlike for large businesses which can utilise their wide ranging assets by diversifying their sources of finance, receivables for small businesses are significant assets which they can use as collateral by either selling these receivables outright (as in factoring and invoice discounting) or by assigning them by way security to a financier. However, contracts that contain restrictions on the assignment of receivables present tension between concepts of freedom of contract and the need for free alienability of property. These two opposite positions involve a number of theoretical questions. One of these questions relate to the doctrine of privity according to which assignment of rights, where the creditor/assignor unilaterally assigns the rights to a third party without the consent of the other contracting party (customer/debtor), can be regarded as a method to avoid the privity doctrine. In a sense, prohibition is said to be a strategy to preserve the privity of contract. Another question that anti-assignment clauses and their regulation pose is whether contractual rights can be classified within the framework of assignment as property rights.³

¹ N.B. Cohen, 'Harmonizing the Law Governing Secured Credit: The Next Frontier' 33 *Tex. Int'l. L. J.* 173, 185 (1998).

² S. Schwarcz, 'Towards a Centralized Perfection System for Cross-Border Receivables Financing' 20 *U. Pa. J. Int'l Econ. L.* 455, 456 (1999). For the significance of receivables financing *see also* F. Oditah, *Legal Aspects of Receivables Financing*, at 2 (London: Sweet and Maxwell, 1991).

³ On these points *see generally* M. Bridge, 'The Nature of Assignment and non-assignment clauses' *LQR* 47 (2016); G.J. Tolhurst and J.W. Carter, 'Prohibitions on Assignment: A choice to be made' *Cambridge L.J.* 405 [2014].

However, one thing seems to be certain. Assignability of contracts is regarded as the origin of modern capitalism because it enables small businesses to borrow on a low rate of interest and provide a rapid turnover of capital.⁴ Small businesses will be able to utilise their property and capital (*i.e.* receivables) which may otherwise be prevented.⁵ Contractual restrictions on the assignment of receivables prevent small business' access to certain financing frameworks including factoring, invoice discounting, supply chain financing and discounting of individual finances over an online platform. This is particularly a pressing matter in the relative absence of bank lending in the post global financial crisis era.⁶ To the extent, the assignment relates to receivables or book debts, anti-assignment clauses under English law will begin to lose their significance due to the recent legislative intervention. In the UK with the enactment of Small Businesses, Employment and Enterprise Act 2015 s. 1 and the related regulations arising from this legislation, bans on assignment will be nullified.⁷

UNCITRAL's secured transactions law instruments recognise the effectiveness of assignments made notwithstanding an anti-assignment clause. These include the United Nations Convention on the Assignment of Receivables in International Trade, UNCITRAL Legislative Guide on Secured Transactions and the UNCITRAL Model Law on Secured Transactions. The approach adopted on anti-assignment clauses by these international instruments shows similarity to that in the Canadian Personal Property Security Acts (PPSAs)⁸ and to a certain extent in the Uniform Commercial Code (UCC) Article 9.⁹ The

⁴ J.R. Commons, *Legal Foundations of Capitalism*, 253 (Transaction Publishers, New Brunswick & London, 1995).

⁵ M. Safavian, H. Fleisig and J. Steinbuks 'Unlocking Dead Capital' *Viewpoint*, Note Number 307 (March 2006)

⁶ S. Fraser, 'The Impact of Financial Crisis on Bank lending to SMEs' Econometric Analysis from the UK Survey of SME Finances, (July 2012), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/34739/12-949-impact-financial-crisis-on-bank-lending-to-smes.pdf (accessed October 2016).

⁷ See generally H. Beale, L. Gullifer and S. Paterson, 'A Case for Interfering with Freedom of Contract? An Empirically Informed Study of Bans on Assignment' [2016] *Journal of Business Law* 203; L. Gullifer, 'Should clauses prohibiting assignment be overridden by statute?' 4 *Penn State Journal of Law and International Affairs* 47 (2015). At the time of writing of this chapter Business Contract Terms (Restrictions on Assignment of Receivables) draft Regulations 2015 that refine s. 1 of the SBEEA had not been finalised and it was still in draft form.

⁸ See *e.g.* Ontario Personal Property Security Act section 39 reads as follows: "The rights of a debtor in collateral may be transferred voluntarily or involuntarily despite a provision in the security agreement prohibiting transfer or declaring a transfer to be a default, but no transfer prejudices the rights of the secured party under the security agreement or otherwise." British Columbia Personal Property Security Act Section 41(9) reads as follows: "A term in a contract between an account debtor and an assignor that prohibits or restricts assignment of the whole of the account or chattel paper for money due or to become due is binding on the assignor, but only to the extent of making the assignor liable in damages for breach of contract, and is unenforceable against third parties" Saskatchewan Personal Property Act section 41(9) also provides a similar regulation of anti-assignment clauses whereby the anti-assignment clause cannot be enforceable against third parties and breach of anti-assignment clause makes the assignor liable against the debtor thus making it binding on the assignor.

basis of these provisions holds the assignor liable in damages for breach of the underlying contract and not the assignee or the secured party. However, the debtor of the underlying contract cannot terminate the contract as a result of that breach. It can be argued that norms that nullify bans on assignment have become international customary law. These can be found under both civil and common law jurisdictions.¹⁰

This chapter will examine the UNCITRAL's approach to anti-assignment clauses in its secured transactions law instruments. The chapter will first explain what anti-assignment clauses are and why they are used commercial transactions. The chapter will then explore why anti-assignment clauses need to be regulated. Finally, the chapter will analyse the approach of the UNCITRAL's secured transactions law instruments to anti-assignment clauses. These instruments include the UN Convention on the Assignment of Receivables in International Trade, the UNCITRAL Guide on Secured Transactions Law and the UNCITRAL Model Law on Secured Transactions Law. Conclusions will summarise the arguments.

What are anti-assignment clauses and why are they used in contracts?

Anti-assignment clauses are contractual clauses that prohibit one party (generally a service provider, supplier or seller in a contract) from assigning or transferring the benefit arising from this contract to a third party. These types of clauses are generally found in standard terms and conditions¹¹ where the negotiation of the contract is not often possible. Debtors or buyers, with strong bargaining powers, generally insist on inclusion of an anti-assignment clause in order to protect their interests. These clauses are generally problematic for assignees (financiers/lenders), particularly in the assignment of bulk receivables. This is because the existence of an anti-assignment clause requires assignees to check each document, in order to ascertain whether the assignment is banned between the assignor and the debtor. The administrative cost involved in due diligence increases the cost of credit. Rendering the

⁹ UCC Article §9-401; §9-406(d) Cmt.5. Particularly, UCC Article §9-402 which protects the secured party/assignee from any liability based on contract or tort arising from debtor's acts or omissions.

¹⁰ In Latin, free assignability is called "*Pactum de non cedendo*". Free assignability is generally recognised by some of the Roman Law influenced Civil law systems, for instance, under Swiss Code of Obligations (article 164) and Turkish Code of Obligations (article 162(1)) and under some Common Law systems such as by the UCC Article 9 regime *see e.g.* UCC §9-406(d) and UCC §9-408(a); s. 354(a) of the German Commercial Code (Handelsgesetzbuch, HGB).

¹¹ 'Large organizations such as universities and local authorities commonly incorporate [anti]-assignment clauses in their standard terms of trading.' M. Bridge, *Personal Property Law* 159 (3rd ed., Clarendon Law Series, 2002).

restriction on assignments ineffective may have the potential to increase small businesses' access to finance by allowing them to use different financing techniques.

A prohibition on the assignment of right to payment may be considered as 'contrary to public policy as an unacceptable restraint on alienation.'¹² Free assignability is necessary to protect the bona fide purchaser.¹³ In principle, all receivables are assignable unless the assignment is prohibited by agreement, statute or due to public policy considerations.¹⁴ Free assignability is vital for 'both businesses and consumer affairs, since credit is commonly obtained on the security of insurance policies, hire-purchase contracts and traders' and builders' book debts.'¹⁵ The debtor has a legitimate interest in insisting on an anti-assignment clause. Debtor prefers predictability and protection against a change in the creditor. Debtor also prefers, for legal certainty, that there will be good discharge upon making payment to the original creditor without having to deal with someone else with whom she has no previous business dealing.¹⁶ However, it can be argued that to a certain extent, debtors may be protected by debtor protection rules.¹⁷

Anti-assignment clauses may take a number of forms.¹⁸ These include a simple condition that restricts assignment of the benefit the contract; conditional restriction on the assignment of the contract where the condition requires approval of the debtor or satisfaction of certain requirements; the restriction may be a promise not to assign; or the contract may be personal to the parties,¹⁹ hence the impossibility of its transfer. There are certain reasons as to why

¹² L. Gullifer (ed.), *Goode on Legal Problems of Credit and Security*, London: Sweet and Maxwell, 4th ed., 2009, 107-8; *Tom Shaw & Co., v. Moss Empires Ltd.* (1908) 25 T.L.R. 190. Examples of public policy may include, among others, maintenance and champerty and public servants' remuneration and tort claims.

¹³ G. Gilmore, 'The Commercial Doctrine of Good Faith Purchase' 63 *Yale L. J.* 1057, 1121 (1954).

¹⁴ A/CN.9/397, para. 20. *Mulkerrins v PricewaterhouseCoopers (a firm)* [2003] UKHL 41; [2003] 1 WLR 1937, para. 13 (benefit of a contract may be assigned to a third party without the consent of the debtor and unless there is contractual prohibitions, however, an assignment under s.136 of the Law of Property Act 1925 cannot be objected as there is no debtor's consent requirement). In the UK e.g. Social Security benefit and child benefits are not assignable see Social Security Administration Act 1992 s.187; Pension Schemes Act 1993 s.159; Pensions Act 1995 s. 91. *Re Mirams* [1891] 1 Q.B. 594 where an assignment of the salary of a public officer has been held to be void; *Methwold v. Walbank* (1750) 2 Ves. Sen. 238 and *Liverpool Corp. v. Wright* (1859) 28 L.J.Ch. 868 (where a public officer cannot assign his salary); see also *Arbuthnot v. Norton* (1846) 5 Moo PCC 219 (where it was held that a judge could not assign his salary); for a similar decision in the US see eg *Byers v. Comer* 68 P.2d 671 (Ariz.), modified, 70 P.2d 330 (Ariz. 1937); S. Worthington, 'The Disappearing Divide between Property and Obligation: The Impact of Aligning Legal Analysis and Commercial Expectation' (2007) 42 *Tex. Int'l L. J.* 917, 927-928; A. Bell, *Modern Law or Personal Property in England and Ireland*, (Butterworths 1989) 380. In *Re Freeman* 232 B.R. 497, 501 (Bankr. M.D. Fla. 1999); Restatement (Second) of Contracts §317(2)(b).

¹⁵ B. Allcock, 'Restrictions on the Assignment of Contractual Rights' 42 *Cambridge L.J.* 328 (1983).

¹⁶ F. Mestre, 'Explanatory Report on the Draft Convention on International Factoring' *Uniform L. Rev.* 85, at 117 (1987).

¹⁷ E.g. the Receivables Convention's debtor protection principle and protection of debtor against assignor under article 10(3).

¹⁸ See generally Tolhurst and Carter, above n. 3, at 405-406.

¹⁹ *Nokes v. Doncaster Amalgamated Collieries Ltd.* [1940] A.C. 1014, HL.

anti-assignment clauses are used in business transactions. The main reason is the protection of the debtor's interests. Debtors may often, despite receiving notice of assignment, overlook the notice and pay by mistake to the assignor and do not get good discharge. Losing the right to get a good discharge may mean that the debtor may be compelled to pay for the second time.²⁰ Debtors may want to protect their defences and rights of set-off arising from their dealings with the assignor. While the debtor's defences against the assignor that have arisen before the receipt of the notice of assignment may be set up against the assignee, same arguments cannot be made in relation to the rights of set-off. With the receipt of notice of an assignment, the debtor loses the availability of rights of set-off against the assignee in relation to present and future claims.²¹ The reason is that the assignee has no present or potentially, a future business relationship.²² However, from a debtor protection perspective, as a result of the assignment the debtor must not be worse off which reflects the concept that the assignee takes assignment 'subject to equities'.²³ In *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*,²⁴ Lord Browne-Wilkinson noted that the significant concern of a debtor, in its contractual relationships and in a possible assignment, was the impossibility of relying upon new equities against the assignor after the receipt of notification of assignment.²⁵ A further reason is that the debtor, for commercial reasons and in order to protect its interests, may not wish to deal with a new creditor that it has not dealt with before.²⁶ Similar points were made in *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*. Lord Browne-Wilkinson explained those reasons that led to the use of anti-assignment clauses as follows:

“The reason for including the contractual prohibition viewed from the contractor's point of view must be that the contractor wishes to ensure that he deals, and deals only, with the particular employer with whom he has chosen to deal. Building

²⁰ *Brice v Bannister* (1878) 3 Q.B.D. 569 CA.

²¹ *Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 1 W.L.R. 578 Ch D (where, owing to assignment, claims which have accrued due prior to the receipt of the debtor of a notice of the assignment, debtor's right of set-off have been limited.)

²² *Christie v Taunton, Delmard Lane & Co* [1893] 2 Ch. 175 Ch D.; G. McCormack, *Secured Credit Under English and American Law* (Cambridge University Press, 2004), p.229.

²³ However, it can be argued that as the assignee takes subject to equities the debtor should not have any concerns. For this view see *Mulkerrins* [2003] UKHL 41; [2003] 1 W.L.R. 1937 at [15], where Lord Millett indicates that “the reason that the debtor's consent is not required to an assignment of a debt is that the assignment cannot prejudice him. The assignment is subject to equities, which means that any set-off which the debtor may have against the assignor can be asserted against the assignee”. See also G. Gilmore, “The Assignee of Contract Rights and His Precarious Security” (1964) 74 *Yale L. J.* 217, 227 where he discusses the position of assignee and the defences of the debtor.

²⁴ *Linden Gardens* [1994] 1 A.C. 85; [1993] 3 All E.R. 417

²⁵ [1993] 3 All E.R. 417 at 429; [1994] 1 A.C. 85 at 105.

²⁶ *Don King Productions Inc., v. Warren*, [2000] Ch. 291, 319 where Lightman J., sitting in the Court of Appeal, states that “the purpose of [a non]-assignment clause is the genuine commercial interest of a party of ensuring that contractual relations are only with the person he has selected as the other party to the contract and no one else.”

contracts are pregnant with disputes: some employers are more reasonable than others in dealing with such disputes.”²⁷

In *Linden Gardens* Lord Browne-Wilkinson clarified that a contractual prohibition could prevent an assignment as between the assignee and the customer/debtor; but the assignment is still effective as between assignor and assignee.²⁸ This reasoning considers the fact that “the personal quality of the creditor may be of importance to the debtor, who wishes to avoid the risk of having to deal with an assignee that is more demanding and less flexible.”²⁹ In the same token, transaction costs may increase with the change of creditor. This is “due to the effect of certain provisions in loan agreements such as increased costs and tax clauses”.³⁰ An anti-assignment clause may also increase the cost of credit as an assignee would prefer transactional certainty and the due diligence actions may contribute to the increase of transaction costs. From the assignee’s standpoint the debtor should make the payment to the assignee. If there is a risk of non-payment, this may be reflected in the risk premium.

The legal effect of anti-assignment clauses

The use of anti-assignment clauses generally reflects the tension between free alienability and property views. While free alienability versus freedom of contract position seems to be the legal lens from which from US legal scholarship analyse anti-assignment clauses,³¹ English and Australian scholarship generally looks at the issue from property versus freedom of contract views.³² In the former set of scholarship free alienability denominates ability of the assignor to assign right to payment (receivables) notwithstanding any contractual restrictions to an assignee, therefore, utilise the economic value of the asset; while the freedom of contract denominates the restrictions agreed between the debtor (buyer)

²⁷ [1994] 1 A.C. 85, at 105; [1993] 3 All E.R. 417, at 429; see also *Yeandle v. Wynn Realisations Ltd.*, (1995) 47 Con. L. R. 1, (CA (Civ Div)) (where the Court of Appeal held that “the permission given to the sub-contractor without consent to assign was the power to assign any sum which were or might become due and payable to them under the sub-contract [and] an assignee of a debt was entitled to enforce it but not to enforce the other provisions of the contract.”)

²⁸ [1994] 1 A.C. 85, 108; see also L.S. Sealy & R.J.A. Hooley, *Commercial Law Text, Cases and Materials* 943 *et seq.* (3rd ed., Butterworths, London, 2003). The decision in *Helstan Securities Ltd. v. Hertfordshire County Council* [1978] 3 All E.R. 262, (Q.B.D.) is distinguished in *Linden Gardens* that the anti-assignment clause without a wider prohibition cannot invalidate the assignment between the assignor and the assignee.

²⁹ See R. Goode, *Assignment Clauses in International Contracts*, 3-4 *Revue de Droit des Affaires Internationales/International Business Law Journal*, RDAI/IBLJ 389, 395 (2002).

³⁰ A. McKnight, ‘Contractual Prohibitions on a Creditor’s Right to Alienate Debts’ (2003) 18 *Journal of International Banking Law* 1, 3.

³¹ See e.g. N. Cohen and W.H. Henning, ‘Freedom of Contract vs. Free Alienability: An Old struggle Emerges in a New Context’ 46 *Gonz. L. Rev.* 353 (2010/11).

³² See e.g. Tolhurst and Carter, *above* note 3; Bridge, *above* note 3.

and the assignor (seller) that protect the debtor from dealing with a third party, possibly that she would not want to deal with in the first place.³³ In the latter scholarship, contractual freedom view generally suggests that the restriction of assignment should not have impact on the assignor's right to assign to a third party but could only affect the debtor's obligation. This view suggests that the assignor should be free to assign and as a result of this assignment the debtor's obligation to pay in order to obtain a good discharge changes whereby the debtor must make its payment to the new creditor (*i.e.* the assignee). The assignee, despite having no right to sue the debtor without the assistance of the assignor, unless there is statutory assignment, may avoid the prohibitions through a declaration of trust according to which the assignee has a direct right to enforce the contract as against the debtor.³⁴ The property view (or the benefit of the contract view) generally suggests that the effect of assignment has proprietary characteristics, and in order to be transferred the right needs to be characterised as property. Debts have been recognised as property by the courts of equity.³⁵ Thus, the restriction on assignment has justifiable grounds. These clauses guarantee that the assignor under the contract performs its contract with the debtor and the contract cannot be altered by way of an assignment. The debtor, thus, can be able to protect its property rights and claim that the assignment in breach of an anti-assignment clause is ineffective.³⁶ There is, however, stronger support to recognise effectiveness of assignments made notwithstanding anti-assignment clauses in monetary rights.³⁷

Linden Gardens Trust Ltd. v Lenesta Sludge Disposals Ltd. decision paves the way towards the view that the legal effect of assignment depends on how prohibition clause is understood (construction argument).³⁸ In this decision, House of Lords recognised the

³³ See below for more discussion.

³⁴ For this view see e.g. R. Goode, *Contractual Prohibitions against Assignment* [2009] *L.M.C.L.Q.* 300

³⁵ *Ellis v Torrington* [1920] 1 KB 399, 410-11 "The common law treated debts as personal obligations and assignments of debts merely as assignments of the right to bring an action at law against the debtor and, except in a strictly limited number of cases, did not recognize any such, assignments. Courts of equity always took a different view. They treated debts as property, and the necessity of an action at law to reduce the property into possession they regarded merely as an incident which followed on the assignment of the property."

³⁶ *Barbados Trust Co v Bank of Zambia* [2007] EWCA Civ 148; [2007] 1 Lloyd's Rep 495 at [88] 'The ineffectiveness of the assignment in breach of a prohibition on assignment is understandable. It is not merely a matter of contract but of property.' *per* Rix LJ.

³⁷ See below UN instruments as well as the UCC Article 9 and similar legislations. The difference between non-monetary and monetary rights has been clearly articulated in the Unidroit Principles for International Commercial Contracts (2004). Unidroit Principles recognises the effectiveness of an assignment between the assignor and the assignee where the right is a monetary right despite an anti-assignment clause in the contract between the assignor and the debtor (article 9.1.9 para 1). On the other hand, article 9.1.9 para 2 deals with the non-monetary rights. Anti-assignment clauses will be effective against the assignee where the assigned right is a non-monetary right.

³⁸ [1994] 1 A.C. 85, 105.

effectiveness of a prohibition on assignment but also recognised that the assignment was effective between the assignor and the assignee, and held that:

“... a prohibition on assignment normally only invalidates the assignment as against the other party to the contract so as to prevent the transfer of the chose in action: in the absence of the clearest words it cannot operate to invalidate the contract as between the assignor and the assignee and even then it may be ineffective on the grounds of public policy ... [T]he existing authorities establish that an attempted assignment of contractual rights in breach of a contractual prohibition is ineffective to transfer such contractual rights ... If the law were otherwise, it would defeat the legitimate commercial reason for inserting the contractual prohibition, viz to ensure that the original parties to the contract are not brought into direct contractual relations with third parties.”³⁹

Lord Browne-Wilkinson’s statement suggests that the legal effect of the prohibition depends on construction of the clause. This is because the clause may not automatically prohibit the assignment but rather may subject it to the debtor’s consent.⁴⁰ The right that arises out of the underlying contract between the assignor and the debtor may be a personal right where the performance is a personal one and cannot be performed by anybody but the assignor. Restriction of assignment in this instance is justifiable. That personal right, for not being a property right, cannot be assigned. It can be argued that the construction argument to the extent an intangible is the subject of the transfer does not consider commercial realities, particularly for small businesses. This is because the main intention of the assignor is to access to finance by transferring the right to payment and this leaves no room for construction. It may not always be possible to obtain debtor’s consent. Furthermore, the debtor may have stronger bargaining power which results in an inequality of bargaining power between the debtor and the assignor. The debtor may withhold consent or even may not have the authority to consent to the assignment. The right may be a personal property right in which case it can be, without a doubt, subject of a transfer.⁴¹ While under English law, land and tangible property may be subject to restrictions of assignment, the possibility of restricting the assignability of receivables on the basis of anti-assignment clauses does not meet commercial expectations. It is argued that restricting the ability of the assignor to assign on the basis of stipulations of the party with the stronger bargaining power is simply against

³⁹ [1994] 1 A.C. 85, 108.

⁴⁰ *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, HL

⁴¹ Tolhurst and Carter, *above* n. 3, at 410.

contractual freedom. There is no support for construction argument under the UNCITRAL instruments.⁴² The statement further suggests that the assignment is effective as between the assignor and the assignee, thus the prohibition cannot invalidate the contract (that is also the transfer) between the assignee and the assignor. This would be against public policy by restricting contractual freedom. The UNCITRAL instruments recognise the effectiveness of assignment made notwithstanding a restriction. The statement also suggests that the debtor should not be brought into a relationship with a party (assignee) that in the first place it did not enter into a contractual relationship. It can be argued that in the assignment of receivables, it is the assignor's right to payment (receivables) that is assigned, not the performance. Therefore, it is not the personal obligation but the receivable that is transferred.

Professor Goode suggests four clear possibilities on anti-assignment clauses.⁴³ Firstly, the anti-assignment clause may be effective as between the assignor and the debtor, but has no effectiveness as against the assignee (the assignment is effective notwithstanding an anti-assignment clause). The breach of restriction only grants the debtor the right to claim damages from the assignor. This approach is similar to the UN Convention article 9, UNCITRAL Model Law article 13(1) and (2),⁴⁴ UNCITRAL Legislative Guide on Secured Transactions Recommendation 24. Second interpretation provides that the anti-assignment clause may prevent effectively the assignor from assigning the right to payment to third parties and thus the debtor is not affected and can get a good discharge by paying to the assignor. However, under this interpretation the assignor has the right to enter into a contract to assign the fruits of the contract. Under this interpretation the debtor is effectively protected, as any agreement between the assignor and a third party regarding the assignment of the fruits of the contract, after the debtor's payment, cannot realistically affect the debtor or its interests. Professor McMeel argues that this interpretation appears to be the path that English law is moving towards.⁴⁵ Third interpretation suggests that the anti-assignment clause effectively prohibits the assignor from assigning both the right to payment and its fruits, even after the payment is done. This interpretation clearly excludes the assignor from access to immediate financing and may have adverse financial affects. Professor Goode states that an

⁴² See below.

⁴³ R. Goode, *Inalienable Rights*, (1979) 42 MLR 553, 554.

⁴⁴ UNCITRAL Model Law on Secured Transactions A/CN.9/884.

⁴⁵ For this view see G. McMeel, *The Modern Law of Assignment: public policy and contractual restrictions on transferability*, [2004] LMCLQ 483, at 500 (although he qualified that the law is not explicitly moving towards the view that the second interpretation takes). See also *Linden Gardens Trust Ltd., v. Lenesta Sludge Disposals Ltd.* [1994] 1 AC 85, 105.

anti-assignment clause under this interpretation will be “as a matter of law devoid of effect.”⁴⁶ Although under this interpretation, the aim is to protect the debtor, the assignor’s prohibition of assigning the fruits of the contract should not be limited. Final interpretation suggests that the breach of an anti-assignment clause enables the debtor to claim damages and to avoid the contract with the assignor and thus, reduces or extinguishes the assignor’s right to payment.⁴⁷ That interpretation has been rejected in the UNCITRAL instruments and a breach of an anti-assignment clause by the assignor is not in itself a sufficient reason for the avoidance of the original contract by the debtor, thus the debtor is precluded from strengthening his bargaining power.⁴⁸

Until the introduction of the Uniform Commercial Code Article 9 in the mid-twentieth century, assignability of receivables and the validity of anti-assignment contracts were subject to freedom of contract doctrine. Under this approach prohibitions over assignments were upheld and right to payment could be assigned neither as true sale nor as security.⁴⁹ However, views to in favour of free alienability have gained support by courts and scholars and ways have been found to allow free alienability in the face of contractual restrictions.⁵⁰ UCC Article 9’s approach favours the free assignability of receivables (UCC §9-401(2)). Under UCC Article 9 an anti-assignment clause is ineffective to restrict an assignment or to create a security interest. Also, an assignment notwithstanding an anti-assignment clause is not regarded as a breach of contract. UCC §9-406 and UCC §9-408 override contractual and legal restrictions on the assignor’s right to assignment. UCC §9-406(d) promotes free alienability and renders terms restricting assignment ineffective and applies to accounts other than health care insurance receivables and to chattel paper. This section does not apply to the sale of a payment intangible or promissory note.⁵¹ On the other hand, UCC §9-408 applies in

⁴⁶ Goode, *above* n. 43, at 554; *see also* McMeel, *ibid*, at 500 where he states that the consequences of this could be drastic unless so far as the type (2) consequence was followed. In other words, the anti-fruits clause should not be struck down in its entirety. Furthermore, an anti-assignment clause is inserted for the benefit of the debtor and not anybody else. *See also* Goode *above* n. 43, at 555.

⁴⁷ Goode, *above* n. 43, at 554.

⁴⁸ For more information on this point *see* below n. 82 and the accompanying text thereof. But *cf* Lord Browne-Wilkinson suggested in *Linden Gardens Trust Ltd., v. Lenesta Sludge Disposals Ltd.* that interpretations one and four “very unlikely to occur.” [1994] 1 AC 85, 104

⁴⁹ *See generally* Cohen and Henning, *above* note 31, 354 *et seq.* Some of the significant case law examples of this era on the non-assignability of receivables are *Allhusen v. Caristo Constr. Corp.*, 103 N.E.2d 891, 893 (N.Y. 1952) (“[W]hile the courts have striven to uphold freedom of assignability, they have not failed to recognize the concept of freedom of contract. In large measure they agree that, where appropriate language is used, assignments of money due under contracts may be prohibited.”); *Parkinson v Caldwell*, 272 P.2d 934, 937 (Cal. Ct. App, 1954) (“A contract right has its origin in the agreement of the parties and if the parties by their free agreement place a limitation on the right [of assignment] at the very time of its creation no good reason occurs to us why they may not do so.”).

⁵⁰ G. Gilmore, *Security Interests in Personal Property* §7.6, at 211 (1965).

⁵¹ UCC§9-406(e)

restricted situations where 'contractual and legal transfer restrictions are overridden to the extent they would otherwise "impair the creation, attachment, or perfection of a security interest," but the security interest is not enforceable against the person in whose favour the restriction runs.'⁵²

Why is it necessary to regulate prohibitions on the assignment of receivables?

The above section provides a sketch of complex theoretical and practical underpinnings of anti-assignment clauses. Following this, it is argued that there is a policy based necessity to limit the effectiveness of clauses that restrict the assignment of receivables. While there could be an argument that nullity of anti-assignment clauses interferes with market forces and freedom of contract to pursue regulatory goals, anti-assignment clauses are regarded as barriers to finance, particularly, for small businesses. Their removal enables those small businesses that lack the necessary collateral to obtain bank lending, to have access to invoice financing or factoring. Traditionally, small businesses rely on bank lending. The global financial crisis also caused decrease in bank lending to small businesses.⁵³

Raising finance through factoring is important for small businesses. The significant advantage of factoring is that receivables owed to the small business are assigned outright to the financier (factoring company). The factoring company pays a discounted amount in return to the assignor, rather than collateralising these receivables. Collateralisation enables the financier to take the assets as security to satisfy the claims of creditors. If receivables are collateralised, the title on receivables stays with the assignor. In the case of insolvency, receivables will then become part of the insolvent small business' estate. In this example, the credit risk stays with the small business. This is a significant point in the decision of credit supplied by the factoring company which is based on the value of the small business' receivable rather than the creditworthiness of the small business.⁵⁴ Thus, it is important to have rules that enable and encourage small businesses to utilise factoring more often as a method to raise finance and utilise their dead capital.⁵⁵

⁵² Cohen and Henning, above note 31, at 363.

⁵³ 'Small Businesses seek alternatives as banks leave them in the lurch' *The Economist* 16 August 2014.

⁵⁴ L. Klapper, 'The Role of Factoring for Financing Small and Medium Enterprises' *World Bank Policy Research Working Paper 3593* (2005); see also O. Akseli, *Vulnerability and Access to Low Cost Credit* in *Consumer Credit, Debt and Investment in Europe* (M. Kenny & J. Devenney (eds)), Cambridge University Press (2012), 4, at 15.

⁵⁵ Safavian, Fleisig and Steinbuks, above note 5.

There is a necessity, to the extent financing contracts are concerned, to reduce the disadvantages of inequality of bargaining presents. In terms of anti-assignment clauses, it can be argued that there is an inequality of bargaining power. Freedom of bargaining is regarded as ‘the fundamental and indispensable requisite of progress.’⁵⁶ Small businesses lack both bargaining power and entitlements.⁵⁷ This can particularly be experienced in commercial relationships whereby the small business acts as the supplier or manufacturer for a larger business with stronger and developed resources. Private law processes do not necessarily assist the weaker party in the bargaining process. Thus, the main question in the regulation of these clauses is what shape this regulation should take. In England, Small Businesses, Employment and Enterprise Act 2015 s. 1 nullifies bans on the assignment of receivables.⁵⁸ It was clear that apart from legislative intervention there was no option to remove contractual barriers to assignment (i.e. anti-assignment clauses). During the pre-enactment process, the Impact Assessment document of the Department of Business, Innovation and Skills explained the rationale for intervention as follows:

“38. We have considered alternative options other than legislating to nullify ban on assignment of trade receivables. We could consider offering guidance to businesses on the merits of nullifying ban on assignment of trade receivable clauses or request that businesses join a voluntary code. These measures would not compel businesses to nullify these clauses however, and could create a disjointed effort to resolve the problem.

39. We have therefore concluded that the only through legislation will we be able to remove this contractual barrier.”⁵⁹

From a regulatory perspective this seems perfectly clear. Economic organisation is relies on market system and collectivist system. While market system identifies private law, the collectivist system identifies regulation. Private law processes and therefore, the market system have deficiencies and sometimes cannot assist parties as there are perceived difficulties with bargaining power of parties.⁶⁰ Thus, there is a public interest in regulating these deficiencies with legislation or certain rules. Professor Ogus argues that ‘[a]ccording to

⁵⁶ J. Gordley, *The Philosophical Origins of Modern Contract Law*, 214 (Oxford, Clarendon Press, 1991).

⁵⁷ For reasons of poverty and lack of entitlements see I. Christoplos and J. Farrington, ‘The Issues’ in I. Christoplos and J. Farrington (eds) *Poverty, Vulnerability, and Agricultural Extension*, 1, 3 (Oxford: Oxford University Press, 2004).

⁵⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/383538/draft-statutory-instrument-business-contract-terms-restrictions-on-assignment-of-receivables-regulations-2015.pdf and see also <https://www.gov.uk/government/news/restrictions-lifted-on-invoice-finance-to-help-small-firms-grow>

⁵⁹ ‘Measure to Nullify ban on assignment clauses in a debtors terms of sale’ *DBIS* Impact Assessment document, paras 38-39 (2014),

⁶⁰ See generally the context regulation, markets and private law A. Ogus, *Regulation: Legal Form and Economic Theory*, Chapter 2 (OUP, 1994).

the public interest theory, regulation is to be justified as a corrective to perceived deficiencies in the operation of the market.’⁶¹ If left alone, markets can work inefficiently due to their fragility. The State needs to understand the barriers and to offer businesses solutions.⁶² Thus, it may be necessary to have a legislative intervention.⁶³ A legislative intervention may alter private rights for the benefit of the weaker party. The aim of contracts should be the achievement of ‘a fair division of wealth among the members of society’.⁶⁴ Thus, there is a need for the legislature to create mandatory terms that will prevent the free alienability of rights of payment (receivables). Parties can still agree to insert an anti-assignment clause and agree mutually to adhere to it and their private choice may prevail over the legislative/collective choice. However, in this case, there is at least a legislative protective measure for the benefit of the weaker party in the contractual process.⁶⁵ These regulatory arguments suggest that ‘the coercive power of government can be used to give valuable benefits to particular individuals or groups’.⁶⁶ The regulatory legislative intervention is also necessary to reduce the social costs (the sum of economic costs plus the external costs)⁶⁷ of restricting assignment. While the credit or the business relationship between the assignor and the debtor may be established on the economic/private costs calculation which may be characterised and defined by the strong bargaining position of the supplier, this process may not be concerned about the external costs.⁶⁸ The strong bargaining party may rely on the benefit of the contract and that this should only be performed by the contractual partner and impose a contractual restriction on assignment. The contractual restriction on assignment may be regarded as a condition of extending credit or even entering into a business relationship. This restriction, while perfectly normal under the contractual freedom doctrine, may not take into account third parties’ or the assignor’s interests. In other words, the strong party in the bargaining process, debtor, may not be concerned with the relationship that the assignor, say, a small business, may have with the assignee or other creditors. External costs, in this framework, relate to the costs that people, who have business relations with the assignor,

⁶¹ Ogus, above n. 60, at 15.

⁶² A. Schwartz and R. E. Scott, ‘Contract Theory and the Limits of Contract Law’ 113 *Yale L. J.* 541, 555 (2003).

⁶³ See for a similar view L. Gullifer, ‘Should clauses prohibiting assignment be overridden by Statute?’ 4 *Penn State Journal of Law and International Affairs* 47, 65 *et seq.* (2015).

⁶⁴ A.T. Kronman, ‘Contract Law and Distributive Justice’, 89 *Yale L. J.* 472, 472 (1979).

⁶⁵ See generally Ogus, above n. 60, at 256-257.

⁶⁶ R.A. Posner, ‘Theories of Economic Regulation’ 5(2) *The Bell Journal of Economics and Management Science* 335, 344 (1974).

⁶⁷ On Social Costs see e.g. R.H. Coase, The Problem of Social Cost, 3 *The Journal of Law and Economics* 1 (1960).

⁶⁸ For a similar view see Schwartz and Scott, above note 62, 555 *et seq.*

creditors of the assignor or the society at large, have to pay a price as a result of the economic cost. Assignor's inability to access to finance⁶⁹ due to restrictions on assignment has adverse effect on external costs. Potentially, assignor may default in its payments to third parties or may not pay wages. Thus ability to transfer a right to payment to a financier (by factoring or invoice discounting) is crucial. This will enable particularly small businesses who are entering into transactions with large businesses to be able to utilise the value of their receivables and access to finance via factoring or invoice discounting methods.

UNCITRAL's approach to anti-assignment clauses

The UN Convention on the Assignment of Receivables article 9, UNCITRAL Legislative Guide on Secured Transactions recommendation 24 and UNCITRAL Model Law on Secured Transactions article 13 in a uniform manner regulate rules that recognise the effectiveness of assignments made notwithstanding anti-assignment clauses. Their approach shows similarity to the UCC §9-406 which overrides prohibitions on the assignment of receivables⁷⁰ and the Canadian PPSAs.⁷¹

The Receivables Convention article 9(1) recognises the effectiveness of an assignment by overriding contractual clauses that ban assignment of receivables arising from trade receivables (including sale or lease of goods, credit card receivables or receivables arising out of the licensing of intellectual property).⁷² This rule in the Convention does not affect any national or domestic rules or statutes that ban assignment of receivables. This is because the Convention only applies to an assignment of a receivable where either the assignment or the receivable must be international.⁷³ This requires the assignor and the assignee to be located in different States ('international assignment') or the assignor and the

⁶⁹ It is perfectly possible that the assignor may not be able to obtain bank finance, or other sources of finance and may have to rely on factoring or invoice discounting.

⁷⁰ UCC§§9-406(d) overrides restrictions and provides free alienability of rights to payment and that any agreement between an account debtor and an assignor is ineffective. UCC§9-406(d)(2) and 9-408(a)(2) eliminate all argument that any assignment made notwithstanding an anti-assignment clause nonetheless constitutes breach as between debtor and assignor. *Image Point, Inc. v. JP Morgan Chase Bank, Nat. Ass'n*, 2014, 27 F. Supp.3d 494. *See above*.

⁷¹ *See above*.

⁷² For a more detailed treatment of anti-assignment clauses under the Receivables Convention *see e.g.* O. Akseli, 'Contractual Prohibitions on Assignment of Receivables: An English and UN Perspective' [2009] *J.B.L.* 650. In the United States under the UCC Article 9 regime UCC §9-406(d) provides free alienability of rights to payment and that any agreement between an account debtor (*debtor*) and an assignor is ineffective.

⁷³ UNCITRAL Convention article 1(a) 'Assignment of international receivables' or 'international assignments of receivables'.

debtor must be located in different States ('international receivables').⁷⁴ The assignment made notwithstanding an anti-assignment clause will be effective as against the debtor and the third parties such as the creditors of the assignor and his trustee in bankruptcy. Effectiveness of an assignment in violation of an anti-assignment clause would not adversely affect small debtors, as 'they do not have the bargaining power to insert anti-assignment clauses in their contracts and ... would continue paying the same bank account or post office box.'⁷⁵ This approach would not affect the large debtors as they have sufficient bargaining power.⁷⁶ In a similar token, the UNCITRAL Model Law article 13(1)⁷⁷ recognises the effectiveness of a security right created notwithstanding a contractual restriction limiting the grantor's ability to create a security right. This enables the grantor to be able to utilise its receivables by creating security in return for credit. Article 13(1) does not affect statutory limitations on the creation and enforcement of security rights over consumer and sovereign receivables.⁷⁸

The Receivables Convention protects the assignee, under article 9(2) by providing that the breach of an anti-assignment clause by the assignor is not in itself a sufficient reason for the avoidance of the original contract by the debtor. The liability of the assignor for breach of the anti-assignment clause is preserved under the Receivables Convention; however, the debtor may not terminate the agreement on the grounds of breach of an anti-assignment clause (articles 9(2) and 10(3)) or raise against the assignee. Same approach is adopted under the UNCITRAL Model Law article 13(2). This approach prevents the debtor avoiding the contract and strengthening his bargaining power.⁷⁹ It is argued that the assignee is given some confidence in the outcome of the transaction. The assignor may be held liable for damages for breach of contract if this type of liability is available under the existing national law. Therefore, the right to compensatory damages that the debtor may have under the applicable law has been left outside the Receivables Convention.⁸⁰ Article 9(2) expressly protects a person who is not party to an agreement between the assignor and the debtor on the sole ground that he had knowledge of the agreement. In general, the sole knowledge of the

⁷⁴ UNCITRAL Convention article 3.

⁷⁵ A/CN.9/WG.II/WP.105, para. 83; *see also* A/CN.9/489, para. 103.

⁷⁶ A/CN.9/WG.II/WP.105, para. 83. The Addendum to the Draft Legislative Guide on Secured Transactions paragraph 230 clearly indicates that a debtor such as a consumer may protect itself through statutory prohibitions. A/CN.9/631/Add.1.

⁷⁷ UNCITRAL Model Law on Secured Transactions Article 13(1) reads as follows: "A security right in a receivable is effective notwithstanding any agreement between the initial or any subsequent grantor and the debtor of the receivable or any secured creditor limiting in any way the grantor's right to create a security right."

⁷⁸ UNCITRAL Model Law article 1, paras 5 and 6.

⁷⁹ S. Bazinas, *Key Policy Issues of the United Nations Convention on the Assignment of Receivables in International Trade*, 11 *Tul. J. Int'l & Comp. L.* 275, at 287 (2003)

⁸⁰ A/CN.9/489, para. 99.

assignee of the anti-assignment clause is irrelevant and he cannot be held liable on the sole ground of his knowledge of it by the debtor.⁸¹ There must be additional grounds to knowledge in order for the assignee to be held liable as the third party. The assignee's inferred knowledge is not enough: his knowledge must be actual knowledge.⁸² However, knowledge may be relevant in the case of tortious liability of the assignee such as for malicious interference with advantageous relations.⁸³ The law attributes tortious liability on the assignee where the assignee, with the knowledge of an anti-assignment clause, induces the assignor to breach that clause.⁸⁴ The UCC does not attribute tortious liability to the assignee.⁸⁵ Article 18(3) the Receivables Convention does not allow the debtor to make a claim for breach of anti-assignment clause against the assignee by way of set-off so as to defeat the assignee's demand for payment. The Contracting States are not permitted to make a declaration to override the effectiveness of the provision of free assignability. Under Article 40, a Contracting State is permitted to declare whether an assignment of a receivable owed by a governmental debtor in that State will be excluded from the Convention rules that override contractual anti-assignment terms. Although the Convention overrides the effectiveness of anti-assignment clauses by virtue of article 9, this provision will have no effect on a sovereign debtor who is located in a Contracting State if that State makes a declaration by virtue of article 40 and article 9 does not apply to restrictions arising by statute or other rule of law. It could have been a better and consolidated approach had the Receivables Convention treated sovereign debtors and ordinary debtors on an equal basis and granted effectiveness to assignments made notwithstanding an anti-assignment clause between assignors and sovereign debtors.⁸⁶

UN Convention Article 9, UNCITRAL Model Law article 13 and UNCITRAL Legislative Guide Recommendation 24 in a similar way only apply to trade receivables. They do not apply to financial receivables.⁸⁷ In other words, the scope of these rules is limited to

⁸¹ UNCITRAL Model Law article 13 (2) which reads as follows: "... A person that is not a party to the agreement referred to in paragraph 1 is not liable for the grantor's breach of the agreement on the sole ground that it had knowledge of the agreement."

⁸² *Swiss Bank Corp. v. Lloyds Bank Ltd.* [1979] Ch. 548, at 575, [1979] 2 All E.R. 853, (Ch. D.); *see also* McCormack, *above* note 22, 232.

⁸³ A/CN.9/470, para. 102; *see also* A/CN.9/WG.II/WP.105, para. 85

⁸⁴ A. McKnight, 'Restrictions on Dealing with Assets in Financing Documents: Their Role, Meaning and Effect' 17 *J.I.B.L.* 193, 198 *et seq.* (2002).

⁸⁵ UCC Article §9-406, Cmt. 5 and Article §9-402 Cmt. 2. *Brandes v Pettibone Corp.* 1974, 79 Misc. 2d 651; 360 N.Y.S.2d 814

⁸⁶ *Cf.* A/CN.9/466, paras. 107-115.

⁸⁷ The reason for inapplicability has been explained in the UNCITRAL Legislative Guide on Secured Transactions as follows: "It does not apply to so-called "financial receivables", because where the debtor of the receivable is a financial institution, even partial invalidation of an anti-assignment clause could affect

the assignment of receivables arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of real property; arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information; representing the payment obligation for a credit card transaction; or owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.⁸⁸

Conclusions

Financing small and medium sized businesses is vital in the relative absence of bank lending in the aftermath of the global financial crisis. One method to reduce the financial tension on small businesses is to enable them to utilise their receivables. This can be achieved by removing barriers before the assignability of receivables. Recognising the effectiveness of assignments made notwithstanding anti-assignment clauses is part of many modern commercial laws. While nullifying anti-assignment clauses may distort market practices and forces, the law should also support small businesses at times of crisis. The law should enable them to utilise their capital by assigning their receivables in bulk and assigning their future receivables. Therefore, to the extent these clauses are inserted by the strong bargaining party to the contracts against small businesses, they should be rendered ineffective which will enable small businesses to use factoring and securitisation financing techniques to access to credit.⁸⁹ This can only be achieved through a legislative intervention which offers lower transaction costs than negotiating the anti-assignment clauses. UNCITRAL's texts have the necessary detailed and modern approach to achieve this result.

obligations undertaken by the financial institution towards third parties. Such a result is likely to have negative effects on important financing practices, such as those involving the assignment of receivables arising from or under securities or financial contracts” para. 108, at 93. *See also* UNCITRAL Model Law on Secured Transactions Guide to Enactment A/CN.9/885 para. 100.

⁸⁸ UN Convention article 9(3); UNCITRAL Model Law article 13(3); UNCITRAL Legislative Guide Recommendation 24(3).

⁸⁹ *See also* UNCITRAL Legislative Guide on Secured Transactions para. 110, at 93.