

7 November 2017

Francis Evans Esq
Department for Business, Energy & Industrial Strategy
1 Victoria Street
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Dear Mr Evans

THE BUSINESS CONTRACT TERMS (ASSIGNMENT OF RECEIVABLES) REGULATIONS 2017

The role of the Financial Markets Law Committee (the "FMLC" or the "Committee") is to identify issues of legal uncertainty, or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

In fulfillment of this role, the FMLC has monitored the progress of the draft Business Contract Terms (Assignment of Receivables) Regulations 2017 (the "Regulations") produced by the Department for Business, Energy & Industrial Strategy ("BEIS"). The Regulations are made further to Section 1 of the Small Business, Enterprise and Employment Act 2015 (the "Act"). The draft explanatory memorandum accompanying the Regulations observes that the purpose of the Regulations is to facilitate access to finance for businesses by nullifying terms in business contracts which prohibit the assignment of receivables or hinder a person to whom a receivable is assigned from exercising his/her rights.¹ As such, the Regulations provide that terms (i) prohibiting the assignment of a receivable, (ii) preventing the assignee from determining the validity or value of a receivable, or (iii) hindering their ability to enforce a receivable, have no effect.²

The latest draft of the Regulations, as laid before Parliament in September 2017,³ draws upon findings from a consultation launched in December 2014 and follow-up engagement with stakeholders.⁴ Responding to this draft, the Committee would like to direct your attention to a significant issue of legal uncertainty that arises when considering the Regulations from a conflict of laws perspective.

Conflict of laws—the law of the assigned claim

The conflict of laws is an area of law which relates to how courts should deal with cases which involve a "foreign" element—that is, an element of the case which is connected to a foreign legal system.⁵ Where such a foreign element exists, the question of which substantive law is applicable may be unclear. In this case, the courts will follow conflict of laws rules which designate the applicable substantive law based on criteria known as "connecting factors"; examples of connecting factors include domicile, place of performance of a contract, and place where property is situated. Conflict of laws rules exist at both national and international levels,⁶ although such rules are by no means necessarily homogenized, and different legal systems may have different (and, sometimes, incompatible) conflict of laws rules.

It can be observed that the Regulations concern the assignment of claims, owing to their focus on the assignment of a specific type of claim—receivables. This has a particular meaning in a conflict of laws context, because under the law of England and Wales, and Northern Ireland, there is a conflict of laws framework pertaining to the assignment of claims. Article 14 of Regulation (EC) No 593/2008 on the law applicable to contractual obligations ("Rome I") provides uniform conflict of laws rules in relation to the effects of an

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assignment (i) with respect to the parties to an assignment contract (the assignor and the assignee), and (ii) with respect to the relationship between the assignee and the debtor.⁷ The conflict of laws rule that governs the latter—the enforceability of the assignment against the debtor—is the law of the assigned claim. Furthermore, the European Commission recently launched a consultation in order to determine which conflict of laws rule should apply in respect of third party effects of assignment of claims (the “Consultation”).⁸ The FMLC has long advocated the use of the law of the assigned claim as an effective conflict of laws rule in this context,⁹ a position which correlates with that taken under English common law.¹⁰

The law of the assigned claim is thus, from a conflict of laws perspective, of integral importance to the assignment of claims. In this context, the FMLC wishes to highlight the concern that the Regulations—as currently drafted—may have left the door ajar for an assignee or factor to challenge contractual choice of law, tampering with the law of the assigned claim and giving rise to the possibility for legal uncertainty.

Regulation 1 paragraph 3

This concern derives primarily from Regulation 1 paragraph 3 of the Regulations:

These Regulations have effect notwithstanding any contract term which applies or purports to apply the law of Scotland or some country outside the United Kingdom, where the term appears to the court, or arbitrator or arbiter to have been imposed wholly or mainly for the purpose of enabling the party imposing it to evade the operation of these Regulations.

The draft explanatory memorandum to the Regulations suggests that this provision is intended to ensure that the Regulations are effective and enforceable where:

- a) at least one of the parties to the contract is located in England, Wales or Northern Ireland; but
- a) the contract is not written under the law of England and Wales or of Northern Ireland; and
- b) the court determines that the choice of jurisdiction was wholly or mainly to avoid them.¹¹

Regulation 1 paragraph 3, therefore, empowers the court to ignore a choice of law clause; this is a significant encroachment on contractual freedom. This step is, moreover, made all the more concerning in light of the fact that the meaning of “wholly or mainly” is not specified and it is unclear what factors the court will take into account when making this determination. With concepts such as “wholly” and “mainly” left vague and ambiguous, unaccompanied by detail or guidance, Regulation 1 paragraph 3 introduces uncertainty for market participants as regards the stability of their contractual choices

Furthermore, and perhaps more concerning, as Regulation 1 paragraph 3 allows a court to ignore a foreign choice of law provision within a contract, it may also act to subvert the application of established conflict of laws rules which look to the law of the assigned claim. This may have ramifications for the relationship between the assignee and the debtor, and the legal position of third parties.

Regulation 2(a)

A complementary point can be made in respect of Regulation 2(a), the broad wording of which gives room for legal uncertainty. This provision states that a term in a contract has no effect to the extent that it:

prohibits the assignment of a receivable arising under that contract or any other contract [emphasis added]

With this drafting, parties to assignments may possibly seek to argue that the regulation empowers an English court—when confronted by an English law-governed assignment—to invalidate clauses in the assigned claim without first ascertaining whether that claim is governed by a different applicable law (such that the Regulations should not, in fact, apply to the contract of the assigned claim). While the risk of this argument ultimately succeeding may be considered remote, it is worth observing that litigation on a standard market fact pattern does not have to be successful to prove potentially disruptive and, were a view to develop that Regulation 2(a) gives a court the latitude to invalidate clauses in an assigned claim governed by foreign law, this would lead to considerable market uncertainty.

As a related point, the FMLC is aware that the City of London Law Society (the “CLLS”) has raised the concern that Regulation 2(a) is inconsistent with Section 1(2) of the Act.¹² This is on the basis that Section 1(2) of the Act defines a “non-assignment of receivables term” as a term in a contract which prohibits the assignment of receivables arising “under the contract or any other contract between the parties”.

Recommendations

Taken together, Regulations 1 paragraph 3 and 2(a) pose a significant threat to the freedom of parties to establish their own choice of law clauses, and potentially cut across established tenets of private international law. As a first step, therefore—and particularly in respect of Regulation 1 paragraph 3—the FMLC recommends that thought be given to the interaction between the current approach and the conflict of laws framework surrounding the assignment of claims.

Furthermore, ambiguity inherent in the current drafting—particularly as regards the meaning of “wholly or mainly” at Regulation 1, and the reference to “any other contract” at Regulation 2—acts to exacerbate legal uncertainty. Should BEIS, notwithstanding the FMLC’s recommendation above, intend to preserve its current approach, the FMLC recommends that as a minimum BEIS:

- a) illuminates the criteria that will be used under Regulation 1 paragraph 3 to establish when a choice of law term has been imposed “wholly or mainly” for the purpose of enabling the party imposing it to evade the operation of the Regulations (and indeed, provides some further information as to what “wholly or mainly” means); and
- b) replaces the reference to “or any other contract” at Regulation 2(a) with “or any other contract to which these Regulations apply”[emphasis added].

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me to arrange such a meeting or should you require further information or assistance.

Yours sincerely,


Joanna Perkins
FMLC Chief Executive

Copied to: Peter Evans

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- ¹ See the draft explanatory memorandum to the Regulations, p.1 section 2, available at https://www.legislation.gov.uk/ukdsi/2017/9780111160305/pdfs/ukdsiem_9780111160305_en.pdf.
- ² See the explanatory note appended to the Regulations, available at http://www.legislation.gov.uk/ukdsi/2017/9780111160305/pdfs/ukdsi_9780111160305_en.pdf. See also the impact assessments, available at http://www.legislation.gov.uk/ukia/2017/140/pdfs/ukia_20170140_en.pdf and Section 1 of the Small Business, Enterprise and Employment Act 2015, available at <http://www.legislation.gov.uk/ukpga/2015/26/section/1/enacted>.
- ³ See fn 2, *supra*, for a link to a draft of the Regulations.
- ⁴ See the draft explanatory memorandum, fn 1, *supra*, p.3 section 8. The results of the consultation and stakeholder engagement can be found at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/451773/BIS-15-441-nullifying-the-ban-on-invoice-assignment-contract-clauses-government-response.pdf.
- ⁵ Jowitt's Dictionary of English Law, Sweet & Maxwell (2010) p.509.
- ⁶ Examples of international conflict of laws rules include those put in place by European Union legislation, and through treaties such as the Hague Convention on the laws applicable to certain rights in respect of securities held with an intermediary (the "Hague Securities Convention"). The Hague Securities Convention became effective as of 1 April 2017, following ratification by three countries: the United States of America, Switzerland and Mauritius.
- ⁷ The text of Rome I is available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:177:0006:0016:en:PDF>.
- ⁸ The European Commission consultation, which ran from 7 April 2017-30 June 2017, on the conflict of laws rules for third party effects of transactions in securities and claims is available here https://ec.europa.eu/info/consultations/finance-2017-securities-and-claims_en.
- ⁹ The FMLC response to the Consultation, advocating the law of the assigned claim, can be found at http://www.fmlc.org/uploads/2/6/5/8/26584807/fmlc_consultation_response_-_conflict_of_laws.pdf. See also the FMLC paper entitled *European Commission Review of Article 14: Assignment; Response to the November 2009 Ministry of Justice Discussion Paper on the effectiveness of an assignment or subrogation of a claim against third parties*, available at: <http://web.archive.org/web/20150921102541/http://www.fmlc.org/uploads/2/6/5/8/26584807/137.pdf>.
- ¹⁰ See *Raiffeisen Zentralbank Osterreich AG v Five Star General Trading LLC and others* [2001] EWCA Civ 68, [2001] QB 825. In this case, the Court of Appeal made it clear that, as far as the common law rules on conflict of laws are concerned, the law of the assigned claim is the correct approach to the third party effects of transactions in claims.
- ¹¹ See the draft explanatory memorandum fn 1, *supra*, p.4 paragraph 8.11.
- ¹² The FMLC has seen a note from the Financial Law Committee of the CLLS addressed to BEIS highlighting several issues of uncertainty arising out of the Regulations.