

Freedom of Contract – a Justified Override? The Business Contract Terms (Assignment of Receivables) Regulations 2018

Dorothy Livingston*

What is the purpose of the Regulations?

Part 1 of the Small Business, Enterprise and Employment Act 2015¹ (the ‘Small Business Act’) was intended primarily to benefit UK small and medium-sized businesses (SMEs) still feeling the effects of the financial crisis as regards access to finance and to make it easier for them to get prompt payment of their invoices and to access bank and other finance. One of the enabling provisions (ss 1 and 2 of the Small Business Act) was for regulations that would make ineffective any ban on assignments of receivables in contracts, with the exception of contracts for some financial products. According to the explanatory notes to the Small Business Act this was to ‘address contractual barriers that can make it more difficult for small businesses to raise finance using their receivables’ – that is the forms of finance usually called factoring and invoice discounting or invoice purchase finance.²

* Consultant – Herbert Smith Freehills LLP; Chairman – City of London Law Society Financial Law Committee.

1 www.legislation.gov.uk/ukpga/2015/26/contents.

2 See government consultation, *Late Payment of Finance, building a responsible payment culture*, published 7 December 2013 and response to consultation, published May 2014, www.gov.uk/government/consultations/late-payment-of-finance-building-a-responsible-payment-culture.

As the Small Business Act was going through Parliament there was consultation on a draft statutory instrument making these regulations, but it was only over two years later, in September 2017, that a draft of the Business Contract Terms (Assignment of Receivables) Regulations³ (the ‘Regulations’) was laid before Parliament. These were not in the form consulted on back in 2015, or in the form of the recast Regulations as laid before Parliament in late July 2018. The September 2017 form of the Regulations was withdrawn in November 2017 and was the subject of considerable amendment before being re-laid in July 2018.

The effect of the changes between the 2017 and the 2018 texts of the Regulations was to limit the ‘override’ effect of the Regulations. In broad terms the 2018 form of the Regulations is limited in its effect to English and Northern Irish law business-to-business (B2B) contracts where:

- the supplier is an SME or a micro-business⁴ at the date when it makes an assignment prohibited by the terms of the contract; and
- at least one of the parties to the contract has entered into it in the course of a business carried on in the UK.

The way that this is achieved and other safeguards contained in the Regulations are discussed in more detail below.

Not only do the recast Regulations reflect the original intention of the enabling legislation, but the changes are important to the ability of UK business to enter into and finance large commercial transactions, raise funds through securitisations and organise project finance; these are financings in which the ability to limit assignment of debts is essential to ensure the availability of payment streams on which repayment of the finance depends. These changes are also important to the continued use of English law in financings worldwide.

Why the fuss?

It is a long-cherished rule of English law that the parties to a contract should be free to agree any terms that they wish, subject only to overriding rules of public policy on validity or enforceability, such as those relating to gambling contracts.⁵ There have been a number of statutory inroads to this rule, relating, for example, to unfair contract terms, particularly in consumer contracts, and in the field of employment law for the protection

3 www.legislation.gov.uk/ukdsi/2017/9780111160305.

4 The UK for statistical purposes classifies businesses with one to nine employees as micro-businesses. These include unincorporated businesses.

5 See discussion of the general principle, for example, by Lord Diplock in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827.

of the employee. This is the first occasion on which an override to freedom of contract has been proposed in respect of a specific term in commercial contracts that is in common usage in English law contracts worldwide and is key to financing arrangements for many complex and high-value projects. Unless well considered, the override could have had adverse impacts on the availability of finance to large businesses and to projects, as well as unnecessarily complicating business acquisition arrangements.

The 2017 form of the Regulations, if it had become law, would have had very wide-ranging effects, in that the draft Regulations:

- applied to all contracts written under English or Northern Irish law, unless English law was the law of the contract only as a result of the choice of the parties;
- applied to contracts between businesses of any size from the biggest PLC to the smallest micro-business;
- were unclear what sorts of transaction might be regarded as an ‘assignment’ and therefore as to the extent of the prohibition;
- invalidated additional terms in the contract as well as the prohibition on assignment, but the extent of the affected terms was unclear;
- applied to current contracts;
- contained very limited exceptions and exclusions;
- in some aspects appeared potentially *ultra vires* in relation to the powers contained in the Act.

The effects would have been to disrupt many contractual arrangements that depended upon the parties maintaining a direct payment relationship with their counterparty, as well as impinging upon financing arrangements of companies far removed from the UK SMEs that the legislation was intended to assist, both in size and location. The degree of contractual uncertainty introduced could have made the use of English law in international commercial contracts unattractive. Some argued that the legislation would not have assisted the aim of improving the access of UK SMEs to finance for their businesses.⁶

The UK Department for Business, Energy and Industrial Strategy (DBEIS) was commendably open to further consideration of the form of the Regulations in light both of the concerns raised and the practicalities of ensuring that the Regulations do indeed provide real additional access to factoring and invoice financing for SMEs and micro-businesses. The form of the Regulations now before Parliament addresses the majority, but not all, of the concerns raised about the 2017 draft and achieves the aim of assisting SMEs and micro-business to access additional forms of finance.

6 See comments by the City of London Law Society to the UK Department for Business, Energy and Industrial Strategy of 13 October 2017, [www.citysolicitors.org.uk/attachments/article/121/The%20Business%20Contract%20Terms%20\(Assignment%20of%20Receivables\)%20Regulations%202017.pdf](http://www.citysolicitors.org.uk/attachments/article/121/The%20Business%20Contract%20Terms%20(Assignment%20of%20Receivables)%20Regulations%202017.pdf).

What contracts will be affected by the Regulations?

Regulation 2(1) states that ‘a term in a contract has no effect to the extent that it prohibits or imposes a condition, or other restriction, on the assignment of a receivable arising under that contract or any other contract between the same parties’.

This is subject to regulations 3 and 4, which limit the types of contract to which the Regulations can apply.

Target contracts

The more complex exclusions and exceptions are dealt with in greater detail below, but it is worth noting that the principal effect of regulations 3 and 4 is that contracts in scope of regulation 2 will be contracts that:

- are entered into by all parties for the purposes of a trade, business or profession (regulation 4(c));
- have a supplier who is an SME or micro-business (and is not a special purpose vehicle) (regulation 3); and
- have at least one party that has entered into the contract in the course of carrying on a business in the UK (regulation 4(d)).

Contracts meeting the description above⁷ could be thought of as the target contracts for the legislation, consistent with the purpose underlying Part 1 of the Small Business Act. As can be seen, a contract meeting this description will be one under which a trading company SME or micro-enterprise is likely to be owed money and issue invoices, which might be the subject of a factoring or invoice financing agreement, if the assignment of the receivables owed under the contract were not prohibited.

‘Or any other contract between the same parties’

The Regulations apply to prohibitions on assignment that appear not only in the contract under which the supply is made, but in any other contract between the same parties. This language is intended to cover the situation where the contract under which the receivable arises is not a simple ‘one-off’ purchase, but is one of a series of orders placed under a more complex contract.

For example, a distribution agreement would provide a framework under which a distributor purchases goods from a supplier, placing orders that vary according to demand for the products. Any term prohibiting or restricting

⁷ The language of the Regulations is defined essentially by a series of negatives, so is paraphrased in order to identify the target contracts in positive language.

assignment of the receivables arising from an individual order is likely to be found in the distribution agreement. Other common types of contract that may be used to lay down terms that apply to multiple receivables are large supply contracts with staged delivery and invoicing arrangements and framework agreements under which a customer can call for supplies as and when they are needed, each supply being separately invoiced.

Exceptions in regulation 4

However, not all B2B contracts meeting the above descriptions are in scope. In particular, regulation 2 does not apply to contracts of four broad types, namely contracts:

1. for the supply of prescribed financial services (regulation 4(a));
2. concerning an interest in land (regulation 4(b));
3. in which one or more of the parties is not a business (regulation 4(c));
4. of hire or bailment of goods (regulation 4(m)), whether or not in the nature of a financing contract.

In addition, several types of contracts for a range of quite narrow, specific purposes are out of scope. Several of these classes of contract, while not relating to prescribed financial services, are similar in nature, or are essential to enable the financing of particular types of transaction:

- a contract that concerns national security interests (regulation 4(e));
- several types of contract in the energy sector (regulation 4(f), (g), (h) and (l));
- a contract that is entered into in connection with the acquisition or disposal of an ownership interest in a business (regulation 4(i));
- various types of derivative contracts that relate to commodities, energy, emission allowances, climatic variables, freight rates, inflation or other official economic statistics entered into on a regulated market or in a number of other organised trading facilities or under a market agreement providing for close-out netting; these are included because although these types of contract are often or mainly entered into as financial contracts, they may not fall within the scope of the exclusion in regulation 4(a) for ‘prescribed financial services’ (regulation 4(j)); and
- a contract entered into by a project company of a public-private project, a financed project or a project concerned with development of land in a designated disadvantaged area outside Northern Ireland (regulation 4(k)).⁸

⁸ See further discussion in relation to special purpose vehicle (SPV) exclusion below.

What is a receivable, who is a supplier and who is a debtor?

A 'receivable' is defined in regulation 1(3) as 'a right (whether or not earned by performance) to be paid any amount under a contract (other than a contract mentioned in regulation 4) for the supply of goods, services or intangible assets'.

Note that if such a right arises under a contract that is out of scope as a result of an exception in regulation 4, it is not a receivable for the purposes of this definition. This appears to mean, for example, that if a contract concerning an interest in land has incidental provisions regarding the supply of services to the property on a specified charging basis, the right to be paid for these services cannot be treated as a receivable for the purposes of the Regulations.

Similarly, where a contract would be in scope if any of the parties entered into it in the course of carrying on a business in the UK, but none of them do so, payments under that contract fall outside the definition of receivables.

'Supplier' is defined by reference to a receivable as the supplier of goods, services or intangibles to whom the amount (for their supply) is payable. Thus, a supplier for the purposes of the Regulations is someone entitled to be paid in respect of a receivable as defined.

'Debtor' is also defined by reference to a receivable as the person liable to pay that amount.

How do you identify if a contract has a supplier that is an SME or micro-business and is not a special purpose vehicle?

Regulation 3 is devoted to this issue. Its drafting is 'back to front', in that regulation 3(1) excludes from the effects of regulation 2 any assignment made at a time when the supplier is a large enterprise or a special purpose vehicle (SPV). A supplier will be a large enterprise (and its contracts will be outside the scope of the Regulations) unless it satisfies one of the conditions in regulation 3(3). Where the supplier is a large enterprise, the debtor's rights against the supplier (eg, to enforce a prohibition on assignment) and the assignee (eg, to refuse to accept a notice of assignment as effective and to maintain rights of set-off arising against the supplier) would remain intact and regulation 2 would have no effect.

While the drafting is possibly neater, it is confusing in that it means that the parties whose contracts are affected by the Regulations are identified in conditions to the defining exception to regulation 2, rather than it being

stated clearly in regulation 2 that it only applies to contracts in which a person described in regulation 3(3) is the supplier.

Parties identified in regulation 3(3) are the parties whose contracts are in scope and affected by the Regulations

It is therefore the contracts of the suppliers that satisfy one of the conditions in regulation 3(3) that are in fact within the scope of the Regulations and prohibitions, conditions or restrictions on assignment in their contracts are the ones made ineffective by regulation 2. The vast majority of those parties are SMEs and micro-businesses (although the contracts of a large unincorporated association or partnership supplying goods, services or intangibles in the course of a business could remain in scope).

Unincorporated businesses

Regulation 3(3)(a) covers all suppliers that are individuals, partnerships (other than LLPs) and unincorporated associations. This category would cover all micro-businesses that are not incorporated. This category applies regardless of the nationality or habitual residence of the business.

Of course not all contracts with people or entities in this category will be B2B contracts and it is in relation to this group that the broad exclusion in regulation 4(c) is most likely to have relevance. If the supplier or any other party to the contract is acting for purposes that are outside a trade business or profession (eg, if the supplier is a private party selling a car or the debtor is a consumer) then regulation 2 will have no effect. The Regulations are intended only to apply to B2B contracts.

Bodies corporate

Suppliers that are UK companies and LLPs and have filed accounts in relation to a relevant financial year are covered provided that they qualify as small or medium-sized on the basis of those accounts and are not large enterprises or members of a large group (regulation 3(3)(b), (c), (f) and (g)). ‘Relevant financial year’ is defined as the last financial year before the receivable is assigned for which the supplier has filed accounts and a ‘large group’ is defined by reference to the Companies Act 2006 (regulation 1(3)).

Suppliers that are UK companies and LLPs that are not overdue with their accounts are covered unless they are members of a large group (regulation 3(3)(d), (e) and (h)).

Bodies corporate incorporated outside the UK are in scope if they would have been had they been incorporated in the UK (regulation 3(3) (i), (j) and (k)).

Contracts of special purpose vehicles are taken out of scope

Even where a supplier falls into one of the categories in regulation 3(3), its contracts are taken out of scope by regulation 3(1) if that supplier is an SPV.

This provision is important to ensure that structured financings and securitisations in which assets used as security or to provide an income stream to repay a large loan (usually much larger than an ordinary trading SME would enter into) can be isolated in a newly formed company or partnership, often not part of any group and commonly known as an SPV. Such a company or partnership will (at least in the first year of its life and potentially for longer) often be an SME.⁹ It is integral to a financing of this type that the income stream from the assets held by its SPV can be dedicated to repayment of the financing and cannot be diverted by assignment to some other purpose.

Sometimes a structure will involve an SPV whose role is to hold money raised under a financing and to ensure that it is applied only for the purposes of the financing (eg, on construction work, servicing a loan, paying key suppliers, etc). Again, diversion of the money it raises into a different financing structure is not acceptable, certainly without the consent of its financiers. Therefore it is important to the viability of this form of financing that contractual prohibitions on assignment by these SPVs should remain enforceable.

Regulation 3(4) defines an SPV as:

‘a firm, wherever it is incorporated or established, that carries out a primary purpose in relation to –

the holding of assets (other than trading assets¹⁰); or

the financing of commercial transactions,

which in either case involves it incurring a liability under an agreement of £10m or more.’

Regulation 3(5) clarifies the meaning of ‘liability’ to include present and future liabilities whether certain or contingent and provides for the full amount of a contingent liability under a guarantee or indemnity to be taken

9 This is because an SPV will generally have no employees and may not meet the balance sheet or turnover tests that would make it a large enterprise for the purposes of the Companies Act 2006.

10 Within the meaning of the Income Tax (Trading and Other Income) Act 2005.

into account. It also provides that in the case of limited recourse finance the liability is to be counted in its full amount, without regard to any reduction or limit by reference to the value of the SPV's assets. Finally, it provides for a liability in a foreign currency to be calculated in sterling at the time when the liability was incurred.

Interaction with project company exception in regulation 4(k)

While a project company as defined in regulation 4(j) may often be set up specifically for the project and have the primary purpose of holding the project assets, this is not true of all project companies.

Some will be pre-existing companies whose activities have been narrowed down to a specific project and others will have a wider remit, so that the holding of project assets or the financing of commercial transactions are not the primary purpose of these project companies. Nevertheless, in order to ensure the financeability of the project, they need to be able to ensure that project income is not capable of being taken out of any project financing structure. For example, they may need to provide that the operator of the project assets (not necessarily the same company) can dedicate its income stream (after meeting operating expenses) to repaying the debts incurred to build the project.

Essentially, the project company exception fulfils a different purpose from that of the SPV exclusion.

What clauses will be made ineffective?

Regulation 2(1) provides that a term of a contract to which the Regulations apply 'has no effect to the extent that it prohibits or imposes a condition, or other restriction, on the assignment of a receivable under that contract or any other contract between the same parties'.

Definition of 'assignment'

There is, despite criticism of the lack of it, no definition of what is meant by 'assignment' so it must be given its normal meaning under English or Northern Irish law, as applicable. Legal dictionaries give definitions as short as 'transfer of rights under an agreement'. In the UK, the law might, for example, take account of the explanation in Article 14(3) of the Rome I

Regulation,¹¹ which will be retained EU law after the UK leaves the EU and thus continue to be part of the law of the UK jurisdictions. This provides that the concept of assignment in that Article includes ‘outright transfers of claims, transfers of claims by way of security and pledges or other security rights over claims’.

It seems fairly clear that English law is consistent with the description in Article 14(3) and regards assignment as including not only absolute assignments and express assignments by way of security or by way of charge, but also a charge over debts and a floating charge, whether or not the word assignment is mentioned.¹²

A key feature of an assignment under English law is that it only transfers rights. Any obligations that remain to be performed remain with the assignor, as does liability for performance of those that have been performed.

The question is often raised whether the term ‘assignment’ can extend to novation, a tripartite agreement in which the original contracting parties release each other and one of them enters into a new contract in the same or similar terms under which the rights and obligations of the retiring party are assumed by a new party. The settled view under English law is that a novation should not be viewed as a type of assignment;¹³ it is not a transfer of rights coupled with a transfer of obligations, but the essence of a novation is a new contract the rights and obligations under which are also new, even if of the same character/amount as the rights and obligations of the retiring party.¹⁴ The debtor, the retiring party and the new party will always have consented and changed their respective positions as a result of a novation. There would be no policy reason to treat novations as assignments for the purposes of the Regulations, as financiers in invoice discounting or factoring arrangements

11 Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I), Art 14. ‘Claims’ in the context of the Rome I Regulation may be understood as the right to claim a debt, usually a monetary amount.

12 *Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 1 WLR 578, discussed in *Chitty on Contracts*, 32nd edn, 2015, para 19-071, although this depends on an understanding of the nature of a floating charge.

13 See *Chitty on Contracts*, 32nd edn, 2015, para 19-089. An assignment may be subject to ‘equities’: eg, rights that the original debtor had against the original supplier for misrepresentation, but these are not available following a novation.

14 This position is muddled by the EU Proposal for a Regulation on the law applicable to the third party effects of the assignments of claims, which is intended to complement Art 14 of the Rome I Regulation. The draft Regulation reveals the intention to include ‘transfer of contract’ and transfer by novation in its remit (Art 5(e) of COM(2018) 96 final (2018/0044(COD)) of 12 March 2018), stating that a novation is the functional equivalent of a transfer of a contract (see Recital (31)). This legislation is still in draft and aspects of it have been heavily criticised. The UK government has exercised its right of opt-out, so it may never become part of English or Northern Irish law.

would not wish to assume any obligations to the supplier's customers, but only to have the right to the amounts owed by those customers to the supplier.

Term is ineffective 'to the extent that'

The language of regulation 2(1) is intended to ensure that the whole contract is not rendered void or unenforceable by an offending term – only so much of the contract as actually prohibits or imposes a condition or other restriction on assignment of a receivable is made ineffective. The use of the term 'ineffective' seems to make it clear that the inclusion of prohibitions on assignment is not unlawful (and there are no penalties for their inclusion). Ineffectiveness would, however, involve the inability to enforce the term or claim damages for its breach, or a discretionary remedy, such as an injunction, to prevent future breach.

As there is a temporal element in identifying whether a contract is within scope, according to whether a supplier is in one of the categories set out in Article 3(3), it seems possible for a contract that at one point in time was in scope to come out of scope. This could occur, for example, if a supplier that was previously a medium-sized company filed accounts that showed it to have grown to be a large company or to have become a member of a large group of companies. In that case it seems that the prohibitions on assignment, etc, in its new contracts and older contracts not already the subject of an assignment of receivables arising under them will be effective and enforceable. An assignment of future receivables made before the company changed status would seem still to be enforceable, even though the receivables arise after a change of status, although it is possible that view might be challenged in the courts.

Is the rest of the contract affected in any way?

Regulation 2(2) extends the description of contracts that impose a condition or other restriction on assignment to include terms that prevent a person to whom a receivable is assigned from determining the validity or value of the receivable or their ability to enforce the receivable. This is in the nature of an 'anti-avoidance' provision, intended to ensure that other contract terms, such as confidentiality provisions binding on the supplier, cannot be used to prevent the assignee from valuing the receivable or being able to give notice of assignment or seeking to collect directly from the supplier's customer, where this is appropriate.

There were very considerable concerns that this provision would run a coach and horses through a wide range of legitimate clauses and might do considerable damage to the interests of the supplier's customers.

Requirements for consent to assign

It seems clear that regulation 2(2) would render ineffective a term that required a supplier to get prior consent from a customer before assigning receivables due from that customer. It is less clear that a simple notice provision, where the supplier is obliged to inform the customer of an assignment, would be caught although where a contract makes prior notice mandatory, this term would seem likely to be ineffective.

Negative pledges

A negative pledge is a restriction on the creation of security. It is most often found in a financing document, such as a first charge, so as to restrict the creation of a second or subsequent charge without the consent of the first chargee. These financing contracts would be outside the scope of the Regulations. Negative pledges are, however, sometimes found in commercial contracts, including occasionally in supply contracts that are in scope. On the basis that 'assignment' includes a charge, then these negative pledges would be rendered ineffective by the Regulations.

Status of contractual rights of set-off

One concern was that a contractual right of set-off might be viewed as a de facto restriction on assignment. The Regulations themselves are silent on this possibility, but the explanatory notes take the somewhat unusual step of stating expressly: 'A contractual right of set-off which the debtor could have exercised against the assignor prior to the assignment or but for the assignment is not a term that imposes a condition or other restriction on assignment of a receivable for the purposes of these Regulations.'

In the Regulations themselves, the fact that they anticipate that an assignee will wish to be informed about set-off or other defence (regulation 2(3)(m)) suggests that contractual rights of set-off are to be regarded as a normal incident of a supply contract and not to be recharacterised as a restriction. The explanatory notes to a statutory instrument are, of course, not law and would not be referred to where the law is clear. They do, together with the terms of regulation 2(3) (discussed below), suggest that the terms 'condition' and 'restriction' should be construed narrowly, an approach that would be

consistent with the respect for party autonomy embedded so strongly in English law.

Confidentiality clauses

Another concern is that confidentiality clauses might be rendered wholly unenforceable, allowing not only an assignee, but any third party, to get their hands on confidential know-how or intellectual property without the supplier being liable for wrongful disclosure. As a result, regulation 2(3) links the application of regulation 2(2) to difficulties for the assignee to obtain specific items of information. These include information about:

- the parties (regulation 2(3)(a) and (b));
- the contract terms (regulation 2(j) and (k));
- performance of the contract, such as the goods, services or intangibles supplied or to be supplied, time of supply, the price and any discount or credit note and any counterclaim or set-off raised by the customer (regulation 2(3)(d), (e), (f), (g), (l) and (m)); and
- the situation in relation to value added tax (VAT) (regulation 2(3)(c), (h) and (i)).

Of itself this would not seem to prevent a general confidentiality clause being rendered ineffective, although the ‘to the extent’ language in regulation 2(1) may be intended to enable such a clause to be partially enforced, for example if a supplier wrongfully disclosed technical know-how to a business rival of a customer in a context wholly unrelated to the assignment of a debt. However, regulation 2(3) is extremely useful in providing a checklist of what should be disclosable and would enable future contract drafting to deal specifically with these items, separately from other confidentiality provisions, so as to minimise the impact on provisions of more importance.

Interaction with data protection law

Suppliers who supply information about individuals associated with their business customers to an assignee remain bound by the terms of data protection law. This imposes certain obligations when dealing with personal data about individuals, including those associated with a business customer. These obligations would arise whether the supplier was giving information in a context where there was no prohibition on assignment in the supply contract or the supplier was taking advantage of the ineffectiveness of relevant prohibitions or restrictions pursuant to the Regulations and proposes to give information to an assignee. Regulation 2(3)(a) and (b) contemplate that a supplier will wish to disclose personal data to an assignee, for example

where the customer is an unincorporated business (so its identity is that of an individual) or where contact information identifying an individual is required by the assignee.

There is a general duty to process this information fairly and lawfully and this would require the supplier to (1) provide relevant individuals with fair processing information; and (2) satisfy a legal basis for processing personal data:

- In order to satisfy the fair processing requirement, the supplier would need to ensure that the relevant individuals have been informed that their data may be disclosed to third parties such as the assignee (along with all other fair processing information mandated by the data protection legislation) via a privacy policy or via another form of communication (eg, an email).¹⁵
- The supplier seems likely to be able to justify its disclosure of the personal data to the assignee on the 'legitimate interests' legal basis (assuming that the disclosure of this personal data will not cause unjustified harm to the individuals associated with the business customer and the individuals would reasonably expect this disclosure to take place), which means that it will not be necessary to obtain their express consent.¹⁶

Contracts not governed by English or Northern Irish law

The Regulations only apply in exceptional circumstances involving an intention to evade the impact of the Regulations

The intention of the Regulations is that they should apply only to contracts governed by English or Northern Irish law. Legislation in relation to Scots law is a devolved matter for the Scottish administration. This is stated clearly in the first paragraph of the explanatory notes. It is thought likely that the Scottish Assembly will introduce similar legislation, but this has not yet occurred.¹⁷

In terms of the Regulations themselves, the intention is to be inferred from regulation 1(4), which extends the application of the Regulations to contract terms that apply the law of Scotland or of a country outside the UK in certain limited circumstances, namely 'where the term appears to the

15 Regulation (EU) 2016/679 known as the General Data Protection Regulation (GDPR), Arts 5(1) (a), 13 and 14.

16 GDPR, Art 6 sets out the processing conditions, one of which must be satisfied in respect of each disclosure. Article 6(f) sets out the 'legitimate interests' condition.

17 Note that although the key factor is the governing law of the contract, a supplier within scope from anywhere in the world may benefit from the Regulations as regards all its contracts governed by English or Northern Irish law that any party has entered into in the course of carrying on a business in the UK (even if that business is confined to Scotland) (see regs 3, 4(c) and 4(d)).

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 assessment of the purpose of the choice of law would be fact specific and the court or tribunal would have to move beyond the terms of the contract to consider the surrounding circumstances: first identifying whether there was a party who ‘imposed’ the contract term, whether they were the party in whose favour the prohibition, condition or restriction on assignment would operate and whether they or the contract had any connection with the chosen jurisdiction that would justify the adoption of that governing law. For example, if a branch of a Polish business operating in England decided to choose Polish law for contracts with UK suppliers to this business, that may be done because the supplier wishes to use its home law for as many of his business contracts as it can. Even more so, who could criticise a Scottish business for choosing Scots law for all its UK contracts?

On the other hand, if a large UK business previously using English law for its contracts with UK suppliers, and operating predominantly in England, suddenly chose to adopt, say, the law of the Isle of Man, or of Malta or of the Republic of Ireland for all its UK contracts, this might seem irrational and possibly motivated by a desire to enforce prohibitions on assignment. Even then, it would be a matter of fact and degree: Brexit may cause some large businesses to move their centre of operations to a continuing EU Member State, so justifying a change of governing law for its contracts.

If a different governing law were chosen only for the prohibition on assignment and the rest of the contract were governed by English or Northern Irish law, this would be a pretty clear signal that evasion of the Regulations was intended, to the point where it would unlikely to be worthwhile taking this step. Cases are therefore likely to arise as a challenge to the governing law of the whole contract.

Which courts and tribunals would apply regulation 1(4)?

Regulation 1(4) is a direction to courts or arbitral bodies. Obviously it will apply where those courts and tribunals hearing relevant cases are within England and Wales or Northern Ireland as the Regulations will form part of the law of forum of the case. Whether they can or should be applied by other courts is doubtful. The Regulations, with their contractual override,

are in the nature of public policy or mandatory rules,¹⁸ which other fora may disregard unless hearing a case where the applicable law clearly is English or Northern Irish law. Where the parties have chosen, for example, the law of the Republic of Ireland and the jurisdiction of the Irish courts, those courts are free to accept that choice at face value and to decide the case in accordance with Irish law.

The provision may, however, give rise to some litigation both in the UK and elsewhere, particularly where the intervention of the insolvency of the supplier leaves a good deal of money turning on the question whether the Regulations apply to assist an assignee enforce against the debtor; in the circumstances of an insolvency, the debtor's right of set-off against the supplier may be lost or limited if the assignee has given a valid notice of assignment to the debtor before the commencement of the insolvency. It is also conceivable that a dispute could arise on enforcement of a judgment of a Scottish or third jurisdiction judgment or arbitral award in England and Wales or Northern Ireland.

When will the Regulations come into force?

The Regulations will come into force the day after the day on which they are made: that is the day after the date of the final affirmative resolution needed to make the Regulations. At the time of writing the Regulations have already been approved by the House of Commons and are due to be debated by the House of Lords on 17 October, which means they are likely to come into effect on 18 October 2018.

Are existing contracts caught?

No – the Regulations will only apply to contracts entered into on or after 31 December 2018 (regulation 1(2)).

18 See the Rome I Regulation, Arts 9 and 21. As the Regulations do not appear to make prohibitions on assignment unlawful or their performance (eg, if a supplier chooses to get express consent for an assignment when the Regulations rendered this unnecessary, he would not be acting unlawfully), Art 9(3) of the Rome I Regulation does not seem to be engaged. Article 9(3) would allow a court or tribunal outside England and Wales and Northern Ireland to give effect to the Regulations as mandatory provisions of English or Northern Irish law where the contract was to be or had been performed in one of those jurisdictions, provided that the Regulations were (1) recognised as mandatory provisions and (2) 'rendered performance of the contract unlawful'.

What will be the effect of the Regulations?

The principal effect of the Regulations is to place business customers of SME and micro-business suppliers in the same position, regardless of whether the terms of their supply contract (or other agreement) with the supplier did or did not prohibit, place any condition on or restrict assignment of receivables.

Economic impact

This may have an economic effect on the position of the customer that had sought to prohibit or restrict assignment by its supplier, if the receivables it owes are assigned and valid notice of assignment is given. This may limit or extinguish any rights of set-off the customer would have had if no valid notice were given.

The impact will vary from case to case: some factoring or invoice discounting arrangements rarely lead to notice of assignment being given and the customer remains unaware of the arrangement.

As the impact of the Regulations has been limited to contracts where the supplier is an SME or a micro-business, the size of the risk will be limited by the size of debts such companies would normally be owed. The risk and impact have been very materially limited by the changes between the 2017 and 2018 versions of the Regulations. Large customers of these much smaller businesses would seem to be well placed to adjust to this risk, but it will also fall on SME and micro-business customers of SME and micro-business suppliers.

Preparing for the change

Affected businesses have a short window before the end of 2018 in which to consider and implement any changes in their contract forms in the light of the Regulations.

Large businesses that require suppliers to contract on the large business's standard terms and conditions are the most likely to need to review their contract forms and decide whether to maintain terms that may be made ineffective by the Regulations, or take note of the policy behind the Regulations that SMEs and micro-businesses should not be subjected to prohibitions or restrictions on assignment.

In any event these businesses may wish to revise their confidentiality clauses so as to allow disclosure of the information set out in regulation 2(3) to financiers, so reducing the risk of compromising the enforceability

of general confidentiality clauses in relation to other matters, such as commercial know-how, which may be much more important.

Lawyers working on projects, structured financings and securitisations will need to consider the steps necessary to ensure that the commercial contracts underlying the project or financing contain effective negative pledges or prohibitions on assignment where these are important to the efficacy of financing structures.

Financial businesses engaged in factoring and invoice discounting and their new potential SME customers will need to consider their new opportunities and work on the identification of contracts that are within the scope of the Regulations.