EXPLANATORY MEMORANDUM TO

THE BUSINESS CONTRACT TERMS (ASSIGNMENT OF RECEIVABLES) REGULATIONS 2018

2018 No. 1254

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The assignment of receivables (i.e. invoices and other rights to be paid money under a contract) is a mechanism by which businesses are able to raise finance based on money owed to them. This instrument will facilitate access to finance for businesses, by nullifying terms in business contracts which prohibit or restrict the assignment of receivables. This includers terms which prevent a person to whom a receivable is assigned from enforcing it or determining its validity or value. The Regulations do not apply if the person to whom the receivable is owed is a large enterprise or a special purpose vehicle and various types of contracts are excluded from the scope of the Regulations

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.2 The territorial application of this instrument is limited to England, Wales and Northern Ireland.

3.3 The instrument applies only to England, Wales and Northern Ireland as the Secretary of State does not have the power to make regulations in relation to contracts to which the law of Scotland applies (see section 1(6) of the Small Business, Enterprise and Employment Act 2015).

3.4 This instrument has minor or consequential effects outside England, Wales and Northern Ireland where a contract specifies that the applicable law is the law of England and Wales, or of Northern Ireland. Such effects could also arise where one of the parties seeks to show that a contract term which applies or purports to apply the law of Scotland or some country outside the United Kingdom does so wholly or mainly for the purpose of enabling the party imposing it to evade the operation of the Regulations.

3.5 In the view of the Department, for the purposes of Standing Order No. 83P of the Standing Orders of the House of Commons relating to Public Business, the subject-matter of this entire instrument would be within the devolved legislative competence

of the Scottish Parliament if equivalent provision in relation to Scotland were included in an Act of the Scottish Parliament.

3.6 The Department has reached this view because it considers that the purpose of the instrument relates to contract law, which is within the devolved legislative competence of the Scottish Parliament.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England, Wales and Northern Ireland.

4.2 The territorial application of this instrument is set out in Section 3 under "Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)".

5. European Convention on Human Rights

5.1 Andrew Griffiths MP, Parliamentary Under Secretary of State, Minister for Small Business, Consumers and Corporate Responsibility, has made the following statement regarding Human Rights:

"In my view the provisions of the Business Contract Terms (Assignment of Receivables) Regulations 2018 are compatible with the Convention rights."

6. Legislative Context

6.1 The operation of business contracts is typically governed by common law rather than legislation. We considered alternative options to legislating, including a voluntary code for businesses. However, previous attempts by the recruitment industry suggest that such codes have limited impact, despite considerable support in that instance from the Office of Government Commerce.

6.2 Furthermore, such an approach would inevitably entail significant cost and effort on the part of businesses, as they would need to produce their own code of conduct which could result in a somewhat disjointed approach to the problem. We were not convinced that we could create a sufficiently strong incentive for large debtors to rewrite their standard contract terms and have concluded that only through legislation will we be able to remove this contractual barrier to invoice finance.

6.3 The Regulations exclude any service of a financial nature, defined in sections 1(4)(a) and 2 of the Small Business, Enterprise and Employment Act 2015. This definition is widely-drawn and includes among others all forms of leasing, loan relationships, insurance, banking and all types of securitisation and derivative transactions. Other types of contract are excluded for similar reasons and are listed in regulation 4. It is recognised that many of these contracts rely on non-assignment for sound commercial reasons and that freedom of contract in these instances should be preserved.

7. Policy background

What is being done and why?

7.1 Businesses depend on having adequate cash flow to meet their liabilities and often require access to external sources of finance in order to invest and grow. For growing businesses in particular, invoice finance is an important way of securing the working capital they need.

7.2 Invoice finance allows a business to assign the right to future payment to a finance provider in exchange for funds typically representing 80% of the value of the invoices. This type of finance is especially valuable in those sectors where businesses has to wait a long time between issuing an invoice and receiving payment. Using invoice finance, payment is received within a few days and modern contracts allow suppliers to raise finance flexibly, against individual invoices of their choice. Currently around 40,000 firms in the UK use invoice finance; it is estimated that this is around 10% of the number of businesses that could potentially make use of it.

7.3 Commercial contracts routinely contain provisions that prohibit the assignment of invoices due under the contract. Where there is a ban on invoice assignment, finance providers have to use other means to offer finance, such as requesting the debtor to allow assignment (which may be refused) or using a work around such as a separate trust account or power of attorney. This increases the cost of providing invoice finance and if the measures cannot be implemented or are not cost effective, it may lead to a refusal of invoice financing.

7.4 The Regulations state that terms in business contracts that prohibit or restrict the assignment of receivables, including terms which prevent the assignee from exercising their rights, shall have no effect. This will enable more businesses to access invoice finance. The Regulations will also contribute towards wider policy objectives of diversifying finance markets and encouraging competition. This should make the business finance market more accessible and provide entrepreneurs with cheaper and more readily available finance.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 The Regulations do not amend another instrument

10. Consultation outcome

10.1 On 7 December 2013, Government published the discussion paper BIS/13/1324 *Building a responsible payment culture*. This asked whether removing contractual barriers to the assignment of invoices would be helpful to small businesses. The Government response BIS/14/793 was published on 30 May 2014. Both of these documents are available at https://www.gov.uk/government/consultations/late-payment-of-finance-building-a-responsible-payment-culture. The links are as follows:

Discussion paper:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273436/bis-13-1234-building-a-responsible-payment-culture.pdf

Response:
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/315462/bis-14-793-building-a-responsible-payment-culture-government-response.pdf

10.2 On 6 December 2014 Government published a consultation BIS/14/1232 together with a draft Statutory Instrument BIS/14/1232/AN1 and a draft Impact Assessment BIS/14/1233. These three documents are available at

https://www.gov.uk/government/consultations/invoice-finance-nullifying-the-ban-on-invoice-assignment-contract-clauses.

10.3 There were 20 responses to the consultation, which are were summarised in a document published on 27 February 2015 available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/408130/bis-15-165-nullification-of-ban-on-invoice-assignment-clauses-summary-of-responses.pdf. A summary of the main points raised is given below.

10.4 The Government response BIS/15/441 was also published on 27 February 2015 and is available 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.

10.5 The consultation of December 2014 led to responses from trade representative bodies, including the Asset Based Finance Association and the Federation of Small Business; invoice financers ranging from large banks to small providers; and legal practitioners. The consultation received 20 responses with 60% being supportive of the policy.

The responses suggested that nullification of ban on assignment clauses should:

- Apply to business to business contracts only (and not to consumer contracts or contracts with a public authority);
- Extend to all businesses regardless of size (but see below);
- Exclude financial services contracts. This is because the functioning of some financial market products relies on non-assignment;
- Exclude contracts with interests in land. This is because there are already laws in place with regards to the assignment of interests in land;
- Not create any special provisions for supply chain finance arrangements. This will allow suppliers to opt into supply chain financing or seek alternative arrangements with other invoice financers;
- Permit debtors to take action against suppliers if they breach commercial confidentiality;
- Begin from the commencement of the Regulations, in other words the provisions will not apply retrospectively to contracts entered into before the Regulations come into force;
- Apply where at least one party (assignor or assignee) operates in the UK under the law of England and Wales.

10.6 Following this consultation, draft regulations reflecting the principles above were drawn up and laid before Parliament. Further representations were then received from the legal profession through the City of London Law Society, raising fresh concerns about the operation of the draft regulations and their potential impact on the use of English law for international contracts. In view of these concerns the draft regulations were withdrawn for further consideration and engagement with the legal profession and invoice finance providers. In light of these discussions we have modified the content of the instrument as set out below.

Large enterprises and special purpose vehicles

10.7 The proposal was that the Regulations should extend to all companies regardless of size, with exclusions made where necessary according to the nature of the contract being entered into. Following the consultation, persuasive arguments were put forward by the legal profession that this could damage the use of English law for large commercial contracts, particularly overseas, by causing uncertainty as to whether a contract fell within a particular exclusion.

10.8 The policy objective is to give freedom of choice for suppliers to use invoice finance, while preserving key legal principles including freedom of contract and the evolution of contract law without statutory intervention. Since the main concern is for small and mid-sized businesses, it was agreed that 'large enterprises' should be excluded from the scope of the Regulations. A 'large enterprise' is defined in regulation 3(2) and (3): this is a business that is not an individual, a partnership, or a company or Limited Liability Partnership (LLP) which is classed as small or medium-sized under the Companies Act 2006 or corresponding LLP legislation. Businesses incorporated overseas that would meet the relevant criteria if they were companies formed under the Companies Act 2006 are also within scope. However all companies or LLPs that are members of large groups are classed as large enterprises.

10.9 Special purpose vehicles, which are firms with a specific purpose in the financing of a project, are also excluded since their effectiveness relies on the parties being certain that receivables will be paid as set out in the contract. These exclusions preserve the attractiveness of English law for large commercial transactions.

Commercial confidentiality

10.10 Our original approach suggested that the Regulations would "permit debtors to take action against suppliers if they breached commercial confidentiality". We now think that this would have provided powerful customers with an easy way to prevent the assignment of debt. They could have claimed that information on the existence of the customer or the amount of the debt was confidential, with no requirement to justify why this was the case.

10.11 Our revised approach will avoid this risk. Debtors will still be able to enforce confidentiality clauses, save only for information that is essential for the assignee to be able to assess the value of the receivable and their ability to enforce it, as set out in regulation 2(3). This will protect commercially-sensitive information such as pricing and specifications.

National Security

10.12 The Regulations will not bind the Crown so the Ministry of Defence, for example, would always have been able to prevent its direct suppliers from assigning invoices where that assignment could affect national security. However, this exemption would not have applied further down the supply chain, where both parties were private sector businesses. The Regulations now provide that where a contract concerns national security interests, that contract can be excluded from the scope of the Regulations.

Additional Exclusions

10.13 In discussion with stakeholders, several types of contract were identified where application of the Regulations could have unintended consequences. This is typically because the nature of the contract requires certainty between the contracting parties

that they will be dealing with each other rather than an assignee. Exceptions have therefore been made for:

a) petroleum licences and related contracts, as well as to contracts involving CFD counterparties as defined in the Energy Act 2013;

b) contracts for the sale of a business and 'transitional services agreements' which are agreements for one party to provide services to the other following a sale, provided that they include a statement that this is the nature of the contract;

c) options, futures, swaps and other derivatives contracts that do not fall under the definition of 'financial services' in the Act but nonetheless have similar characteristics;

d) contracts entered into by project companies, for example in a public-private partnership or a utility project;

e) certain contracts connected with nuclear decommissioning; and

f) leasing contracts that do not fall under the definition of 'financial services'.

Territorial Extent

10.14 The earlier government response stated that the Regulations would "only apply where the parties conduct a business to business transaction using English contract law and one of them carries on business within the UK". Regulation 4(d) provides that the Regulations do not apply where the parties are based outside the United Kingdom and the law of England and Wales or of Northern Ireland applies only as a matter of choice. In this case, the parties can, if they wish, agree a contract term banning the assignment of receivables and this term would be valid. This provision ensures that the Regulations do not act as a deterrent to parties located overseas choosing the law of England and Wales or of Northern Ireland.

10.15 Regulation 1(4) deals with the case where a contract term applies or purports to apply the law of Scotland or a country outside the United Kingdom. If such a term is determined (by a court or arbitrator) to be applied wholly or mainly to avoid the operation of the Regulations, the Regulations will nonetheless apply. This anti-avoidance measure is based on section 27(2) of the Unfair Contract Terms Act 1977.

11. Guidance

11.1 These Regulations are not accompanied by Guidance.

12. Impact

12.1 The impact on business, charities or voluntary bodies is expected to be beneficial. The impact assessment shows net direct benefits to business of £44.9m and a total net present value (which includes both direct and indirect benefits) of £966m. These benefits are realised through an expected reduction in the cost of invoice finance and more businesses being able to access this type of finance and choosing to do so.

12.2 There is no significant impact on the public sector.

12.3 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 The approach to monitoring this legislation will be to assess the impact on the market for invoice finance once the Regulations come into effect. The Regulations will be reviewed after 5 years to assess their impact on businesses and the wider economy.

14.2 The regulation does not include a statutory review clause.

15. Contact

15.1 Francis Evans at the Department for Business, Energy and Industrial Strategy, Telephone: 0207 215 5794 or email: francis.evans@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Angelina Cannizzaro at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Kelly Tolhurst MP at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.