KEY POINTS

- Assignors and assignees of contractual rights may be liable for damages if an anti-assignment clause is breached, whether or not the clause prevents assignments from taking effect.
- Typical assignees such as secured lenders may be liable for inducing breach of contract, and damages will not necessarily be nominal.
- Secured lenders can take practical steps during due diligence to ensure the effectiveness of assignments and mitigate the risk of liability.

Feature

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Damages for breach of anti-assignment clauses

The effectiveness of restrictions on the assignment of contractual rights has been qualified by statute and potentially by the courts. In these circumstances, obligors may look to their remedies against assignors and assignees, which may include damages for breach of contract and for inducing breach of contract. Akhil Shah KC and Daniel Schwennicke of Fountain Court Chambers analyse the relevant legal principles and provide practical advice to secured lenders seeking to take assignments of contractual rights.

INTRODUCTION

Clauses prohibiting or restricting the assignment of contractual rights give rise to difficult questions of legal policy and doctrine. The case law and commentary in this area have tended to focus on the following question: Does a clause prohibiting assignment prevent the assignee from acquiring ownership in the purportedly assigned right or does it merely stipulate that the obligor/promisor need only perform the contract for or account to the assignor/promisee?

In *Linden Gardens Trust v Lenesta Sludge Disposals* [1994] 1 AC 85 (HL), Lord Browne-Wilkinson appeared to give a straightforward and authoritative answer. If a contract contains a restriction on the assignment of rights under the contract, any purported assignment in breach of the restriction is ineffective, such that the purported assignee does not obtain any proprietary interest in the contractual rights.

Recently, however, there have been inroads into the decision in *Linden Gardens*. First, in *Barbados Trust Company Ltd v Bank of Zambia* [2007] EWCA Civ 148, [2007] 2 All E.R. (Comm) 445, a majority of the Court of Appeal held (obiter) that a covenant restricting assignments could be circumvented by an express declaration of trust by the promisee, and that the beneficiary of the trust could sue the promisor in their own name.

Second, the Court of Appeal in *BP Oil International Ltd v First Abu Dhabi Bank PJSC* [2018] EWCA Civ 14 (again obiter) expressed support for the view that an anti-assignment clause did not prevent the purported assignee from acquiring ownership in assigned contractual rights.

Third, the Business Contract Terms (Assignment of Receivables) Regulations 2018 (the Regulations) created a statutory exception to the decision in *Linden Gardens*. The Regulations apply to contracts for the supply of goods, services or intangible assets under which the supplier is entitled to be paid money, unless the supplier is a large enterprise or special purpose vehicle and unless the contract is of an excepted type (such as, amongst others, contracts for prescribed financial services, contracts concerning land, certain types of derivative contracts and operating leases). Section 2 of the Regulations provides that, unless these exceptions apply "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".

The purpose of the Regulations is to make it easier for SMEs to obtain working capital through invoice financing.

In light of these inroads, what remedies does the obligor/promisor have against the assignor/promisee and/or against the assignee for breach of an anti-assignment clause? This question can also be asked from the perspective of a typical assignee: Could a secured lender be liable to the obligor if an anti-assignment clause is breached?

BREACH OF CONTRACT

The first issue is whether, as a matter of construction, the anti-assignment clause gives rise to an obligation not to assign rather than only (purportedly) invalidating the assignment. The courts have been reluctant to construe an anti-assignment clause as giving rise to such a contractual obligation even where it contains suitable wording (eg the wording in *Linden Gardens*: "The employer shall not without written consent of the contractor assign this contract"). As explained by Millett LJ in *Hendry v Chartsearch* [1998] C.L.C. 1382, this follows from the approach to anti-assignment clauses taken in *Linden Gardens*. Given that an assignment in breach of a restriction is invalid, it is thought that there is no need to take a covenant against assignment.

However, this point is vulnerable to at least two counterarguments. First, the anti-assignment clause may expressly state that a purported assignment in breach of the restriction is a breach of contract, for example by providing that the promisee "shall not assign this contract and any assignment shall be ineffective".

Second, even absent such wording, the correct construction of a clause such as the one in *Linden Gardens* may be that it invalidates any assignment *and* that any attempt to assign gives rise to a breach of contract. If the assignment is given effect despite the restriction (for example by the application of s 2 of the Regulations[1]), then the premise of the preferred construction in *Linden Gardens* (as the single correct

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construction) falls away. Even if the assignment is ineffective, it is not difficult to imagine circumstances in which an ultimately unsuccessful attempt to assign may cause the promisor to suffer a loss. For example, the promisor may overlook the prohibition or misunderstand its effect (particularly in light of the recent case law) and wrongly pay the assignee, suffering a loss if the assignee becomes insolvent. Further, the promisor may incur otherwise irrecoverable costs in defending proceedings wrongly brought by the assignee.

For this reason, damages for breach of an anti-assignment clause will not necessarily be nominal, although it will often be difficult to assess the measure of the promisor's loss (as noted by Smith and Leslie, *The Law of Assignment*, 3rd ed., 25.04). For example, what loss has the promisor suffered if a relatively benign institutional lender is effectively replaced by an aggressive vulture fund (as was the case in *Barbados Trust*)?

INDUCING BREACH OF CONTRACT

If the promisee/assignor is potentially liable for breach of contract, could the assignee be liable for inducing breach of contract? The assignee will, on established principles, be liable if they knowingly and intentionally procure or induce the assignor to break the contract to the damage of the promisor without reasonable justification or excuse.

In practice, the most significant hurdle for any claim against the assignee will be the mental element of the tort. The assignee will only be liable if they:

- knew of the existence of the anti-assignment clause and that it would be breached or turned a blind eye to these matters; and
- intended the breach as an end in itself or as a means to an end.

If the assignee has the means to confirm that the relevant contract contains an anti-assignment clause – for example, because a copy is provided as part of a due diligence process – but does not check the relevant contract, then whether the assignee may be liable will depend on the reasons why the assignee did not check. If the reason is that it would be too burdensome to check a large number of assigned contracts (as, for example, in an invoice financing scenario), the assignee may escape liability: compare *Unique Pub Properties v Beer Barrels & Minerals (Wales) Ltd* [2004] EWCA Civ 586; [2005] 1 All E.R. (Comm) 181 at [31]-[38]. Not, however, where the assignee had cause to believe there was an anti-assignment clause and chose not to enquire. If the promisor is able to establish the requisite knowledge on the part of the assignee, the promisor will have little difficulty in establishing the requisite intention. The breach of the anti-assignment clause would be regarded as an essential part of what the assignee intended to achieve or "the other side of the coin" of the assignment.

TERMINATION

The first issue here is, again, whether the anti-assignment clause can be construed as permitting the promisor to terminate the contract for breach of this clause (or as automatically terminating the contract if the clause is breached). The courts are similarly reluctant to construe an anti-assignment clause as having this effect, and this reluctance is readily understandable. Apart from the doctrines of penalties and forfeiture, the effect of such a construction is that the purported assignment extinguishes the assignor's own right to future performance and consequently any such right which the assignee might obtain from the assignor. If the purported assignment is ineffective against the promisor (per *Linden Gardens*), then termination is an excessive response. If the assignment is effective, then termination will achieve by the backdoor what the clause would otherwise be unable to accomplish.

Nevertheless, an anti-assignment clause may expressly provide for termination as a consequence of breach and might even provide for "cross-default", so that a purported assignment of one contract is a ground for termination of other contracts. Arguably, such an anti-assignment clause would be caught by s 2 of the Regulations, given that it may in substance have the same effect as an express prohibition. But this argument will not assist where the Regulations do not apply.

WHAT LENDERS CAN DO

Given the uncertainties surrounding the effect of anti-assignment clauses and the possibility of a claim by the promisor, what can a lender who wishes to take an assignment by way of security do to protect its position? It is suggested that the lender should take the following steps, where practicable:

(1) check for the presence of anti-assignment clauses as part of its due diligence;
(2) request that the promisor waive any anti-assignment clause before taking an assignment from the promisee and/or acknowledge or consent to the assignment (which may avoid future argument where there might be ambiguity in the clause and may preclude the promisor from taking a contrary position subsequently);
(3) seek to ensure the effectiveness of the assignment by including in the assignment agreement:
   - express declarations of trust over debts prior to performance and collected proceeds;
   - a power of attorney allowing the lender to enforce the debt in the name of the assignor; and
   - a charge over any non-vesting debts; and
(4) seek a warranty that the assigned contract contains no restriction on assignment or transfer of rights under it (which would provide protection against a claim by the promisor unless the assignor becomes insolvent). ■

1 Section 2 of the Regulations would not on its face render an obligation not to assign ineffective. Rather, it merely renders an anti-assignment clause ineffective *"to the extent* that it prohibits or imposes a condition, or other restriction, on the assignment".

Further Reading:

- Restrictions on assignment: the law and loan agreements (2017) 4 JIBFL 212.
- Restrictions on assignment (2018) 9 JIBFL 541.
- Lexis+® UK: Commercial: Practice Notes: The tort of procuring a breach of contract.