Small Business, Enterprise and Employment Bill

Nullification of Ban on Invoice Assignment Clauses

DECEMBER 2014
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1. Foreword from Matthew Hancock

I am very pleased to publish this consultation on the proposal to nullify the ban on invoice assignment.

As Minister of State, I have the opportunity to visit excellent businesses and meet dedicated business owners across the country. Regardless of the size or sector a business is in, I know that cash flow and access to finance is vital.

Lending for small businesses in the UK remains a problem. Between April 2013 and March 2014, 48% of SMEs were turned down for loans over £25k on affordability grounds. But the availability of finance for small business is their lifeblood. It allows small businesses to grow and this in turn energizes the economy and creates jobs. We need to do all we can to remove barriers to small businesses getting the funding they need.

Clearly, the use of invoices as collateral for loans should be a viable funding method. But all too often bans on assignment create extra costs for businesses and in some cases are insurmountable barriers, which can block finance and even lead to insolvency.

This Government has been consistent in its support for small business. The Small Business, Enterprise and Employment Bill will open up new opportunities for small businesses to innovate, compete, and get finance to create jobs, grow and export. Removing obstacles to invoice finance is an important part of this.

Thank you for taking the time to read and respond to this consultation.

Matthew Hancock
Minister of State for Business, Enterprise and Energy
2. Executive Summary

2.1 Invoice finance allows a business to assign the right to future payment of an invoice (known as a “trade receivable”) to a finance provider in exchange for a loan up to the full value of the invoice. Businesses are reliant on a strong cash flow and even a profitable business can come into serious difficulties if it has to wait a long time between completing a job and receiving payment. Invoice based finance can provide a vital source of finance in this intervening period.

2.2 Where businesses encounter bans on invoice assignment clauses they can still often obtain invoice finance by seeking waivers or work-arounds. But this can expose businesses to higher interest and administrative fees. Sometimes no waiver or work around can be achieved, which may stop businesses accessing the finance they need. As part of the Government’s reforms to improve the culture of prompt payment, this consultation seeks views on our proposal to remove ban on invoice assignment clauses.

2.3 Rather than prohibiting businesses from putting bans in contracts, we propose to introduce a regulation which would nullify any bans that are put into contracts (with certain exceptions) after the regulations have come into force.

2.4 To avoid confusion for consumers and to focus the attention of the Regulations on the issue of trade receivables between businesses, we propose to limit the extent of the nullification to business to business contracts only.

2.5 We do not intend to nullify bans on invoice assignment in financial service contracts. We have no evidence to indicate that the problems encountered by small and medium sized enterprises accessing invoice-based finance extend to contracts for financial services. In fact we understand that some financial products would not be able to function without a ban. In the absence of clear evidence of business need, we see no reason to change the status quo.

2.6 In order to focus the regulations on trade receivables, we also do not intend to extend the nullification of bans on invoice assignments to tenancy agreements and contracts creating interests in land.

2.7 We propose that the nullification should not extend to exclusivity clauses for supply chain finance. This will give security to supply chain finance providers on beneficial terms to both suppliers and debtors. In the same way, to protect the debtors’ confidentiality, we propose that nullification of ban on invoice assignment should not extend to clauses in contracts which protect commercial confidentiality.

2.8 We intend to maintain the status quo on the concepts of “set off”. And we propose to extend the ban on invoice assignment to “linked contracts”.

2.9 Contractual disputes between parties are often a part of day to day, business to business interactions. This consultation seeks your views on how best to maintain the current status quo of contractual disputes between parties.

2.10 Finally, the consultation asks for your views on the costs and benefits of the measure on both companies and the invoice finance market.
3. How to respond

3.1 Government appreciates that action on late payment is a complex issue and requires careful balance. We have therefore deliberately phrased the questions as openly as possible and are keen to hear views from right across the whole business community.

3.2 Responses to this discussion paper are welcomed from 6 December 2014 to 11 February 2015.

Process

3.3 Submissions of evidence should be emailed to latepayment@bis.gsi.gov.uk clearly marked as a response to the ‘Nullification of ban on invoice assignment clauses’. This mailbox will be monitored on a daily basis. If further information or clarification is required, we will make contact as appropriate.

3.4 When responding please state whether you are responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents by selecting the appropriate interest group on the consultation form and, where applicable, how the views of members were assembled.

3.5 The consultation response form is available electronically on the consultation page: https://www.gov.uk/government/consultations/invoice-finance-nullifying-the-ban-on-invoice-assignment-contract-clauses until the consultation closes.

3.6 A list of those organisations and individuals consulted is in Annex B. We would welcome suggestions of others who may wish to be involved in this consultation process.

4. Confidentiality & Data Protection

4.1 Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

4.2 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.
5. Help with queries

5.1 Questions about the policy issues raised in the document can be addressed to:

Steve Fisher  
Prompt Payment Team  
Department of Business, Innovation and Skills  
1 Victoria Street, London, SW1H 0ET  
Tel: 0207 215 3315  
Email: steven.fisher@bis.gsi.gov.uk

5.2 If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Angela Rabess  
BIS Consultation Co-ordinator  
1 Victoria Street  
London  
SW1H 0ET  
Tel: 0207 215 1661  
Email: angela.rabess@bis.gsi.gov.uk

The consultation principles are in Annex A.
6. The Objective of the Policy Change

Problem under consideration

6.1 The purpose of this measure is to make it easier for business to access invoice finance. This type of finance allows businesses to use their invoices as collateral for loans. Some commercial contracts contain a clause preventing the assignment of a invoice due under the contract. Because of this ban on invoice assignment, invoice finance providers have to use waivers or work-arounds in order to offer finance. A waiver is an approach by the invoice financier to the debtor in order to remove the obstacle of the ban, with a chance that the debtor may simply refuse the request. A work around might typically involve obliging the client to set up a separate trust account into which they must require monies owed from the debtor to be paid, or establishing a power of attorney to pursue monies owed in trade debt to the client in the case of insolvency.

6.2 Both measures increase the cost of providing invoice finance. In a minority of cases, it seems that if the measures are not cost effective enough to the invoice financier, it may lead to a refusal of invoice finance.

6.3 Often, the ban on invoice assignment is part of a more general ban on assignment clause in the contract that is used with the intention of ensuring that a supplier doesn’t sub-contract. As a result, a business’ access to invoice finance is often unintentionally inhibited.

6.4 At the moment invoice financing is used to obtain a small proportion of the finance small and medium sized businesses borrow. Figures from the Bank of England\(^1\) show that in 2013, £18bn of asset based finance was used by UK businesses, with amounts lent to businesses requesting between £0-£10m totaling £6bn. This compares with £448bn of bank lending to non-financial businesses in 2013, of which £166bn was lent to small and medium enterprises.

Action taken

6.5 In December 2013, we published our discussion paper, “Building a Responsible Payment Culture”\(^2\). This asked whether nullifying the ban on invoice assignment would be beneficial to business. A majority of respondents agreed that removing contractual barriers to selling invoices would help increase access to finance. In the Government Response\(^3\) published in May 2014 we announced our intention to legislate to remove these barriers to financing. Clauses 1 and 2 of the Small Business, Enterprise and Employment Bill provide the broad legislative power to do this. This consultation seeks your views on the detail of how we should nullify bans on assignment.

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7. Consultation questions

Draft Regulations

7.1 This section explains our approach; proposed exemptions; and the expected impact of the proposal on the invoice finance market.

7.2 We also drafted Regulations on our preferred method of nullifying the ban on invoice assignments. You can find our draft Regulations on the consultation page: [https://www.gov.uk/government/consultations/invoice-finance-nullifying-the-ban-on-invoice-assignment-contract-clauses](https://www.gov.uk/government/consultations/invoice-finance-nullifying-the-ban-on-invoice-assignment-contract-clauses).

**Question 1: What comments do you have on our draft Regulations?**

Nullification

7.3 In order to achieve the policy aim of prohibiting bans on assignment we have introduced a regulation which would simply nullify all bans that are put into contracts after the regulations have come into force (with certain exemptions).

7.4 A simple nullification is a model used by the United States of America, in the Uniform Commercial Code (Article 9-406). The Code was drafted by the National Conference of Commissioners on Uniform State Laws and the American Law Institute and is enacted by all 50 states. The Article simply renders consent from the debtor unnecessary when the supplier assigns a debt. The intention of this measure is to not make complex and difficult to understand changes to the law. We think that this approach is simplest, and hence propose to adopt it.

**Question 2: Do you agree that a nullification of ban on invoice assignment is the best way to introduce this measure?**

The scope of the nullification – business to business contracts

7.5 Because this measure is to remove a contractual barrier to invoice financing, the scope of the nullification will cover business to business contracts only. This means that it would not cover any bans on assignment that might exist in business to consumer contracts.

**Question 3: Do you agree that we should limit the extent of the nullification to business to business contracts?**

Financial service contracts

7.6 Whilst we wish to ban invoice assignments, there are some areas that we feel should not be covered by a ban. One of these is financial services contracts.

7.7 We believe that preventing financial services contracts from having a ban on invoice assignment would have unwelcome consequences. For instance:
• An invoice may already be used as security on an existing form of finance, for example in a floating charge issued over a bank loan. In these cases, it’s important to maintain the ability for the bank issuing the loan to forbid the assignment of invoices.

• A business may want to ensure that it maintains a direct relationship with a bank issuing a loan and therefore to prevent assignment of a contract for financial services to a third party.

• Some financial products (e.g. derivative products) are not compatible with invalidating a ban on assignment. Such a ban may compromise the ability of both parties to renegotiate the final amount on an invoice against the cost of other invoices because the third party’s credit rating has not been confirmed.

• We also understand that insurance policies covering loss of, or damage to, property are made non-assignable by the recipient of the insurance policy because that would have a substantial effect on the risk that the insurer takes on.

7.8 Other jurisdictions and conventions have prohibited bans on invoice assignment but have excluded financial services contracts from the prohibition. For instance Article 4 (2) of the UNCITRAL (United Nations Commission on International Trade Law) Convention on the Assignment of Receivables in International Trade lists certain types of financial contracts and products that are not covered by the convention.

7.9 Figures from the Asset Based Finance Association show that most invoice financing happens outside the financial service sector. We have not heard from the sector that there is a business need to change the status quo. In the absence of evidence of a need for change, and given the risks that a ban might involve, we propose to exclude financial services contracts from the nullification proposal.

**Question 4: Do you agree that financial services contracts should be excluded (and hence still be allowed to include bans on assignment)?**

7.10 If we do exclude financial services contracts, then we need to define what these are.

7.11 We propose to exclude those financial services listed under section 40 of the Terrorist Asset Freezing etc. Act 2010. This list covers all financial services including banking, insurance, financial trading and broking. The full list is available in Annex C.

**Question 5: Do you agree with our list of excluded financial services, based on the Terrorist Asset Freezing etc. Act 2010?**

**Question 6: Are there any other activities that should be excluded or other special provisions that need to be taken into account?**

**Tenancy agreements and other contracts creating interests in land**

7.12 We also propose that the ban should not extend to tenancy agreements and other contracts creating interests in land. This is because there are already significant laws in

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place which these regulations do not seek to interfere with. The nullification of ban on invoice assignment might otherwise, for example, interfere with a landlord’s right to prevent a business tenant from assigning their property to another individual in a similar way to a subletting arrangement.

**Question 7:** Do you agree that tenancy agreements and other contracts creating interests in land should be excluded (and hence still be allowed to include bans on assignment)?

### Exclusivity clauses

#### 7.13
Some businesses include exclusivity clauses in their contracts that allow a supplier only to access the creditor’s own supply chain finance scheme and prevent assignment of the invoice to other providers of finance. We have been told by some supply chain finance providers that it would be uneconomic to provide supply chain finance if these exclusivity clauses do not remain in contracts. We consequently do not plan for the nullification of bans on invoice assignment to apply to supply chain finance contracts.

**Question 8:** Do you agree that the nullification of bans on invoice assignment clauses should not extend to exclusivity clauses for supply chain finance?

### Commercial Confidentiality

#### 7.14
Commercial confidentiality can be important to some debtors who may wish to remain anonymous to third parties in a transaction with suppliers. The disclosure of the debtor to the invoice financer compromises that confidentiality. We believe that in cases of commercial confidentiality, debtors should be able to maintain the contractual freedom, including the right to reserve commercial confidentiality, which could prevent an assignment.

**Question 9:** Do you agree that commercial confidentiality is an important contractual freedom for debtors, even if this could mean that an invoice assignment is prevented?

### Linked Contracts

#### 7.15
Contracting parties often agree a ‘master’ contract setting overall terms and conditions for business and then issue individual contracts for individual batches of goods and services. The ban on invoice assignment may be contained in the master contract rather than the specific contract for goods and services. In these circumstances, we think that the ban on assignments should automatically extend to linked contracts (apart from where other specific exemptions already apply).

**Question 10:** Do you agree that the nullification to ban on invoice assignment should extend to linked contracts?

### How the Nullification will work

#### 7.16
We could make Regulations which provide that only invoice financers are allowed to benefit from the nullification of a ban on invoice assignment clauses. But this would make accessing finance more difficult for suppliers. For those institutions that are not defined as
invoice financers, the administrative cost of issuing waivers and work-arounds would remain. This would therefore create a two tier service, which would not benefit suppliers, with the contractual barrier removed for some, but not all financers. We have not identified any organisations which should be excluded from becoming assignors. We consequently do not think it makes sense to prescribe that only invoice financers could benefit from invoice assignment.

7.17 In addition, from a legal perspective it would be difficult to limit the effect of a ban on invoice assignment to certain parties. For example, the term ‘invoice finance’ is not itself an activity that is formally regulated by the Financial Conduct Authority. This would mean that it would be legally difficult to define those to whom assignment would be permitted.

**Question 11:** Do you agree that we should not prescribe who could benefit from invoice assignment? If you do want the regulations to prescribe who could benefit from invoice assignment, how should the regulations do this?

7.18 In Canada, each province has adopted a Personal Property Security Act. Most of these Acts have a provision which allows additional terms to be in place to protect a debtor if damages are incurred by an assignment. We considered whether such safeguards needed to be in place and decided that they were unnecessary.

7.19 The invoice finance market allows suppliers to assign their trade receivables in return for finance. The uncertainty for invoice financers and suppliers is the ban on assignment clause. The intention of this regulation would be to remove any uncertainty in assignment. The inclusion of terms for the debtor would add complexity. This could prevent a small supplier from assigning a debt.

**Question 12:** Do you agree that there is no need to include a provision for the debtor to add specific terms for damages? If not, what provisions should be included?

**Maintaining the Status Quo of Contractual disputes**

7.20 Sometimes, payment in respect of an invoice is reduced or withheld because of a contractual dispute between the parties. Some businesses suggest that ‘disputes’ are sometimes used as a way to delay payment beyond the agreed payment term. But, for the most part, contractual disputes are a normal part of business to business interaction.

7.21 Accordingly, we do not wish to interfere with a business’s ability to discuss contractual concerns directly with its supplier. But a blanket invalidation of bans on invoice assignment may create problems in contractual disputes.

7.22 Therefore, we propose that:

- Where the rights to the payment due in respect of that contract have been assigned to a third party; and
- if the debtor withholds part or all of the payment to the invoice finance provider because of a contractual dispute, the invoice finance provider should take up the dispute with the supplier rather than the debtor. This would maintain the status quo where contractual disputes are dealt with between contracting parties.
Nullification of ban on Invoice Assignment Clauses

Question 13: (a) Do you agree that the status quo position on contractual disputes should be maintained so that, when an invoice is disputed by a debtor, the invoice finance provider should take up the dispute with the supplier rather than the debtor (b) Do you have alternative ways in which the status quo could be maintained?

7.23 Set off is a legal right for a debtor to settle the cost of an invoice against costs incurred to the debtor of a previous invoice. For example, if a supplier were to supply goods to a debtor with some of the goods being faulty, the debtor could subtract the cost of the faulty goods in the next goods invoice. This principle is made difficult by the introduction of a third party who is assigned the right to payment.

7.24 While nullifying ban on invoice assignment may affect a business’s ability to set off debts against other invoices, in practice we believe that businesses will still be able to agree set off arrangements between each other as appropriate.

Question 14: Do you agree that we should not make any special provision with respect to set-off?

Other issues

Question 15: Are there any other issues not covered in this consultation which you think we ought to be considering?

Existing legislation

7.25 We have not identified any changes that are required to existing legislation as a result of these provisions.

Question 16: Do you agree that this measure will not require changes to current legislation?

Enforcement & Timing

7.26 The measure affects contract law, which is enforced by the parties to the contract. Government will not have a role in enforcing the ban.

7.27 The implementation of this measure will apply automatically to contracts agreed after the measure is brought into force. It will not apply retrospectively to contracts already existing when the measure is brought into force.

Question 17: Do you agree that this measure will not necessitate Government enforcement?

Costs and benefits of the measure on businesses and the invoice finance market

7.28 We think that the cost to suppliers and their commercial customers of the measure will be negligible and that invoice financers will bear a minimal one off cost for familiarisation with no further ongoing costs.
7.29 For suppliers, we understand that there will be no costs to them from this policy. We learnt in discussions with stakeholders that the overall awareness of bans on invoice assignment in contracts is limited and this may not change for the foreseeable future. This conclusion limits the scope of suppliers who will be affected.

7.30 For those suppliers who wish to take up invoice financing, they will need no additional resources to access invoice financing. The supplier will be able to access invoice financing as usual, without needing an in-depth understanding of contractual law on assignment of trade receivables. The chances of a supplier receiving invoice financing will increase because a financer will not need to consider the risk of non-payment because of a ban on invoice assignment. The overall cost of receiving invoice financing may decrease as financiers are now able to lend invoice financing without the need to spend money on waivers or work-arounds.

**Question 18: Do you agree that this measure will remove the current costs of putting in workarounds for invoice financiers, benefiting the overall invoice finance market? If not, why not?**

7.31 We also believe that there will be no costs to debtors as a result of this policy. Many contracts will ban assignment in general rather than specifically targeting trade receivable assignment. Debtors will often include a general ban on assignment clause in their contracts to ensure that a supplier does not sub-contract the delivery of goods or services. We decided not to unnecessarily burden debtors with a requirement to review their contracts. Instead, all clauses in contracts containing the ban will be nullified.

7.32 Based on our discussions with industry experts, businesses and academics, we concluded that an outright nullification would not impose a significant burden to debtors. The nullification would also allow debtors certain contractual freedoms, including the right to reserve commercial confidentiality in an assignment.

7.33 We understand that there will be a small cost to invoice financiers by enacting this regulation. Invoice financiers lend money to suppliers on the basis of using their invoices as collateral. It is therefore important for invoice financiers to understand the change to the law which will affect their market and help them calculate the risk of lending to a supplier.

**Question 19: Do you agree that the costs of the nullification for businesses will be very low? If not, why not?**

7.34 Invoice financiers currently have to work around a ban on invoice assignment clauses in a contract. These workarounds cost money, increase the difficulty of accessing invoice finance and reduce the availability of finance that many smaller businesses need to manage their cash flows. In some cases, the presence of a ban on invoice assignment clause is the deciding factor in businesses being declined for invoice finance. So we expect this measure will remove the current costs of putting in workarounds, benefiting the overall invoice finance market. We also expect increases in instances of invoice finance approvals, where previously the presence of a ban on invoice assignment was a deciding factor in a business being declined for invoice finance.
8. Devolution

8.1 Contract law is devolved to the Scottish Government and these draft regulations will not apply to contracts made under Scots law. On publication of this consultation, the Scottish Government will work with stakeholders to identify how this can be taken forward in Scotland. The draft regulations cover contracts made under the law applying in the other parts of the UK.

9. What happens next?

9.1 Government appreciates that action on ban on invoice assignments is a complex issue and requires careful balance. We have therefore deliberately phrased the questions as openly as possible and are keen to hear views from right across the whole business community.

9.2 Responses to this discussion paper are welcomed from 6 December 2014 to 11 February 2015. We will provide a summary of our responses to the consultation within 3 months of the closing date.
Annex A: Consultation principles

The principles that Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation are set out in the consultation principles.


Comments or complaints on the conduct of this consultation

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Angela Rabess,
BIS Consultation Co-ordinator,
1 Victoria Street,
London
SW1H 0ET

Telephone Angela on 020 7215 6402
E-mail to: Angela.Rabess@bis.gsi.gov.uk
### Annex B: List of Individuals/Organisations consulted

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<th>Federations of Small Business</th>
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Annex C: List of Financial Services

(1) In this Part, “financial services” means any service of a financial nature, including (but not limited to)—

(a) insurance-related services consisting of—

(i) direct life assurance;

(ii) direct insurance other than life assurance;

(iii) reinsurance and retrocession;

(iv) insurance intermediation, such as brokerage and agency;

(v) services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services;

(b) banking and other financial services consisting of—

(i) accepting deposits and other repayable funds;

(ii) lending (including consumer credit, mortgage credit, factoring and financing of commercial transactions);

(iii) financial leasing;

(iv) payment and money transmission services (including credit, charge and debit cards, travellers’ cheques and bankers’ drafts);

(v) providing guarantees or commitments;

(vi) financial trading (as defined in subsection (2) below);

(vii) participating in issues of any kind of securities (including underwriting and placement as an agent, whether publicly or privately) and providing services related to such issues;

(viii) money brokering;

(ix) asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;

(x) settlement and clearing services for financial assets (including securities, derivative products and other negotiable instruments);

(xi) providing or transferring financial information, and financial data processing or related software (but only by suppliers of other financial services);

(xii) providing advisory and other auxiliary financial services in respect of any activity listed in sub-paragraphs (i) to (xi) (including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy).
(2) In subsection (1)(b)(vi), “financial trading” means trading for own account or for account of customers, whether on an investment exchange, in an over-the-counter market or otherwise, in—

(a) money market instruments (including cheques, bills and certificates of deposit);

(b) foreign exchange;

(c) derivative products (including futures and options);

(d) exchange rate and interest rate instruments (including products such as swaps and forward rate agreements);

(e) transferable securities;

(f) other negotiable instruments and financial assets (including bullion).