EXPLANATORY MEMORANDUM TO

THE BUSINESS CONTRACT TERMS (ASSIGNMENT OF RECEIVABLES) REGULATIONS 2017

2017 No. XXX

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 the assignment of receivables or hinder a person to whom a receivable is assigned from exercising their rights.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 This entire instrument applies only 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). 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.

3.4 In the view of the Department, for the purposes of House of Commons Standing Order 83P 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.

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

4. Legislative Context

4.1 Section 1 of the Small Business, Enterprise and Employment Act 2015 gives the Secretary of State (or, where the law of Scotland applies, Scottish Ministers) the

power to make regulations "for the purpose of securing that any non-assignment of receivables term of a relevant contract has no effect".

5. Extent and Territorial Application

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

5.2 The territorial application of this instrument is set out in Section 3 under "Other matters of interest to the House of Commons".

6. European Convention on Human Rights

6.1 Margot James 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 2017 are compatible with the Convention rights.

7. Policy background

What is being done and why

7.1 Businesses are dependent on adequate cash flow 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 where a business has to wait a long time between completing a job and receiving payment. 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 are not cost effective it may lead to a refusal of invoice financing

7.4 The regulations state that terms in business contracts that seek to ban the assignment of receivables, or 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 asset finance market more accessible and provide growing SMEs with cheaper and more readily available finance.

7.5 We have considered alternative options to legislating, including a voluntary code for businesses. However, previous attempts by the recruitment industry suggest that it had little impact, despite considerable support from the Office of Government Commerce. 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 industry-wide approach to the problem.

We were therefore not convinced that we could create a sufficiently strong voluntary incentive for large debtors to re-write their standard contractual terms, and have concluded that only through legislation will we be able to remove this contractual barrier to invoice finance.

Consolidation

7.6 The regulations do not amend another instrument.

8. Consultation outcome

8.1 In December 2013, the coalition Government published a discussion paper, "Building a Responsible Payment Culture". This asked whether nullifying the ban on invoice assignment would be beneficial to businesses. A majority of respondents agreed that removing contractual barriers to the assignment of invoices would help increase access to finance.

8.2 The previous administration consulted on the details of how the measures should be implemented in December 2014. A response to publication was published in August 2015.

8.3 A four week consultation period 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.
- Exclude financial services contracts. This is because the functioning of some financial market products rely 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.

8.4 Since consultation, we have had further engagement with stakeholders, and in light of this we have modified the policy in some limited respects. These changes are explained below.

Commercial confidentiality

8.5 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 provide powerful customers with an easy way to prevent the assignment of debt. They could claim that information on the existence of the customer or the amount of the debt is confidential with no requirement to justify why this is the case.

8.6 Our revised approach will avoid this risk. Debtors will still be able to enforce confidentiality clauses, but only to the extent that those clauses do not prevent an invoice financier from receiving sufficient information to be able to assess the value of the receivable and their ability to enforce it.

National Security

8.7 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.

8.8 A further exemption is granted to petroleum licences and related contracts, as well as to contracts involving CFD counterparties as defined in the Energy Act 2013.

Territorial Extent

8.9 The earlier government response suggested 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". The draft regulations are more specific. They will apply to cases where at least one of the parties to the contract is located in England, Wales or Northern Ireland.

8.10 The regulations do not apply where the parties are based in another jurisdiction (i.e. Scotland or a country 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.

8.11 There is an opposite case, where at least one of the parties to the contract is located in England, Wales or Northern Ireland but the contract is not written under the law of England and Wales or of Northern Ireland. So as to ensure that the regulations are effective, they will still be enforceable if it is determined (by a court or arbitrator) that the choice of jurisdiction was intended wholly or mainly to avoid them.

9. Guidance

9.1 These Regulations are not accompanied by Guidance.

10. Impact

10.1 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.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment is submitted with this memorandum and will be published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

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

12. Monitoring & review

12.1 The Government will monitor the effect of these changes and the Regulations will be reviewed after 5 years to assess their impact on businesses and the wider economy.

13. Contact

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