CONTRACTUAL PROHIBITIONS AGAINST ASSIGNMENT

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I INTRODUCTION

This paper addresses the nature and effect of contractual provisions prohibiting the assignment of debts and other contract rights. Other grounds of non-assignability, such as statuory provisions, rules of public policy and the fact that the rights in question are by their nature are personal to the creditor, are outside the scope of this review.

The importance of assignability

The common law has always attached great importance to the concept of alienability of property, regarding it as contrary to the public interest for assets to be tied up indefinitely. So there are long-established rules striking down excessive restrictions on alienation, either as being repugnant to the grant made to the intending transferor or as being contrary to public policy. These rules have traditionally been directed to physical assets in general and land in particular. But in modern commerce transactions involving physical assets are dwarfed in value by dealings in pure intangibles, particularly debts, intermediated securities[1] and derivatives. It is thus important that legal rules based on freedom of contract do not impair the free flow of intangibles in the stream of trade.

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[1]That is, securities held by an investor through an account with a securities intermediary rather than direct from the issuer.

There are other reasons why it is important that rights should be assignable. A leading English work on construction law discusses some of them:

> "The existence of viable machinery for the assignment of contract rights is of considerable importance to the construction industry. In appropriate circumstances, assignment can confer tax advantages. It can also play an effective role in company takeovers and in the arrangements which follow an employer's insolvency. More generally, assignment is an important factor in the saleability of collateral warranties and thus in the saleability of buildings themselves. Where a developer or funder who has extracted such warranties from parties engaged in the design and construction process later wishes to sell the building, his ability to assign the benefit of the warranties to his successor in title clearly enhances the attractiveness of the transaction."[2]

A potential obstacle to this is the contractual provision which prohibits or restricts assignment of contractual rights by one or both parties. Such a provision, which is in common use, sets up a tension between freedom of contract and freedom of commerce which national laws and international conventions have only recently come to address. Those who incur money or other obligations under contracts may have perfectly valid reasons for wishing to bar assignments by their obligees.[3] So such clauses are to be found in many types of contract, including contracts dealing with construction, insurance, project finance, intellectual property and financial products. There are certain types of transaction, such as dealings in securities and derivatives, where the need to preserve the mutuality of dealings for the purpose of close-outs and nettings pushes makes it particularly important to preserve the efficacy of no-assignment clauses. On the other hand, no-assignment clauses are undoubtedly a serious impediment to general receivables financing and there is a growing trend in favour of overriding them.

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[2] Emden, *Construction Law*, vol 1, para [1282].
[3] See below, p 4.

This paper, after briefly describing the reasons for the widespread use of no-assignment clauses, is mainly devoted to an analysis of the present law on their effect. But in the concluding part I shall examine the policy issues and legislative trends.

Some questions

The legal effect of a contractual prohibition against the assignment of a debt or other contract right continues to exercise both courts and commentators. This seemingly simple issue raises a whole host of questions:

1. Is an assignment in breach of the prohibition wholly void or merely ineffective against the debtor?
2. Does a no-assignment clause preclude a mere equitable assignment of the debt, a declaration of trust of the debt, an equitable charge of the debt or any of the above in relation to the collected proceeds?
3. Can a non-assignable contract nevertheless constitute an asset of the assignee? And what happens if the assignor goes into liquidation?
4. If the assignor, having sold the debt to the assignee, refuses to bring proceedings against the debtor for the benefit of the assignee, what remedies, if any, does the latter possess?
5. If the assignee is able to bring proceedings against the debtor by joining the assignor as defendant, will judgment be given in favour of the assignee or the assignor?

Reasons for no-assignment clauses

Before addressing these issues we need to be clear why no-assignment clauses are not uncommonly insisted upon by debtors. There are in fact perfectly legitimate reasons why a debtor may wish to prohibit assignment of the debt.

(1) The debtor may wish to safeguard itself against the consequence of overlooking a notice of assignment, which is that having wrongly paid the assignor it may be compelled to make a second payment, to the assignee, [4] leaving itself with a loss if the assignor has meanwhile become insolvent.

(2) If the debtor is engaged in mutual dealings with its creditor attracting rights of set-off against the debt it may wish to avoid having such rights cut off by receipt of a notice of assignment, which in the ordinary way would terminate mutuality for set-off purposes and thus preclude future cross-claims for being eligible for set-off.[5] This concern for the preservation of mutuality is reflected in such documents as the ISDA 2002 Master Agreement governing over-the-counter derivative transactions, section 7 of which prohibits the transfer of a 2002 Agreement, except in limited circumstances, in order that the original parties can safely rely on mutual dealings to operate the Agreement's close-out and netting provisions. But section 7 permits the transfer of a party's interest in an early termination payment, for this results from the close-out, so that the question of mutuality ceases to be relevant.[6]

(3) The debtor may be reluctant to expose itself to the risk that a relatively benign creditor with whom it enjoys a good working relationship is replaced by a hard-nosed

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[4] *William Brandt's Sons & Co v Dunlop Rubber Co Ltd* [1905] AC 454.

[5] *Roxburghe v Cox* (1881) 17 ChD 520; *Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 2 All ER 741.

[6] It should be noted that mutuality of dealings comes into consideration only where the claims and cross-claims arise from separate accounts so as to form the basis of a right of set-off. Mutual dealings reflected by debits and credits to a single current account, as is the common practice for factoring transactions, do not give rise to a set-off at all, since the account embodies a single indivisible fund and a party's entitlement is only to the ultimate credit balance on the account. See the judgment of Millett J in *Re Charge Card Services Ltd* [1987] Ch 150 and Roy Goode, *Legal Problems of Credit and Security* (3rd edn), para 1-20.

assignee, a particular risk on the sale of distressed debt. So in imposing a no-assignment clause the debtor is not simply being vexatious, it has legitimate concerns that the clause is designed to address.

(4) Finally, the debtor may regard the identity of its counterparty as vital for other reasons. For example, insurance policies covering loss of or damage to property are usually made non-assignable because they cannot be transferred without transfer of the property and this may affect the insurer's risk.[7]

Nevertheless, as will be seen later, in the sphere of general receivables financing there are also strong policy reasons in favour of allowing assignments in breach of such a clause to take effect in order to promote the free flow of receivables in the stream of trade and to permit the acquisition of claims for the purpose of generating a right of set-off, and there are both national laws and international conventions and other instruments which in varying degrees override no-assignment clauses, thereby allowing an assignee both to cut off future rights of set-off by notice of assignment and to claim payment directly from the debtor. There are also international and European restatements of contract law providing rules to that effect.

II BASIC PRINCIPLES

No-assignment clauses and restraint against alienation

In general debts and other contract rights are freely assignable. But assignment may be prohibited by statute or may be negated because, under the express or implied

[7] There is a line of American case law which holds that the an assignment of policy rights after the risk has occurred is effective despite a probition on assignment, the reasoning being that since the assignment is of an accrued claim no increase in risk is involved. See *Northern Insurance Co v Allied Mutual Insurance Co* 955 F2d 1333 (9th Cir 1992) and Gale White, "Corporate Relationships, Successor Liability and Insurance Coverage", unpublished but available at http://www.thefederation.org/documents/white.htm#_edn65.

terms of the contract, the right to performance is personal to the creditor. A no-assignment clause is one method of demonstrating that the right is personal. But what is its effect? Is such a clause void as running counter to the common law rule outlawing restraints on alienation as repugnant to the grant?

No-assignment clause has no effect in relation to parties other than the debtor

In an article written many years ago[8] I pointed out the need to distinguish the relationship under examination. The debtor has every right to say that he will deal only with the original creditor. That is a matter of contract, not of property, and therefore falls outside the rules governing restraint on alienation. But the debtor has no legitimate interest in seeking to nullify the transfer of property in the debt as between creditor and assignee or to exclude the assignee's rights against the assignor, only in excluding the assignee's rights against the debtor himself. I suggested that a contract term by which a party undertakes not to assign his rights is capable of at least four interpretations,[9] one of which is that the creditor is not to be entitled to assign the fruits of the contract even as between himself and his assignee, and I argued that such a prohibition would be void as being repugnant to the creditor's ownership.[10] These lines of approach received general support from Lord Browne-Wilkinson in *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd.*[11], who thought that a prohibition

[8] "Inalienable Rights?" (1979) 42 MLR 553 at 554.
[9] See p 9.
[10] Above, n 8, at 556. The common law doctrine that an absolute restraint on alienation by a transferee designed not merely as a contractual undertaking but as a condition attaching to his interest is void as repugnant to the transfer is of long standing. See the decision of the Court of Appeal in *Caldy Manor Estate Ltd v Farrell* [1974] 1 WLR 1303 citing Coke *upon Littleton* (18th edn, 1823), vol II, ss 360 and 361; Charles Sweet, "Restraints on Alienation", (1917) 33 LQR 236, 342; An alternative ground of invalidation is that the restraint is contrary to public policy. See the judgment of Dixon CJ in *Hall v Busst* (1960) 104 CLR 206 at para 13, and the reference therein to Glanville Williams, (1943) 59 LQR 343 at 349-351 arguing that a contract or bond not to alienate was just as void as a restraint on alienation imposed as a condition of the grant.
[11] [1994] 1 AC 85. Lord Browne-Wilkinson's statement of the applicable principles in that case has been generally followed in both Australia and New Zealand. See, for example, *Westgold Resources*

of the last kind might be ineffective on the grounds of public policy[12] but expressed no concluded view on the point. Indeed, it is probably unnecessary to invoke the doctrine of repugnancy, for the inability of the prohibition to prevent the transfer of property can be put on a simpler ground, namely that a mere contract between A and B is inherently incapable of regulating the proprietary effects of a transfer of property from B to C; at most a transfer in defiance of a no-assignment clause exposes B to a claim for damages for breach of contract and to termination of the contract where the breach is repudiatory in character, and where a bond has been given to secure observance of the no-assignment clause then on its breach the bond is forfeit.[13]

Once this principle is grasped, apparent conundrums such as whether a non-assignable contract is a species of property and whether the common law rule against restraints on alienation applies fall away. The reason why the common law rule barring restraints against alienation does not apply to a valid no-assignment clause is not because contract rights do not constitute property - they clearly do in the relations between assignor and assignee - but because the clause operates only as a contractual provision, not as an invalidation of the transfer, and if it purports to render a transfer void it invades the field of property law and is of no effect.[14] This was well put by

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NL v St George Bank Ltd (1998) 29 ACSR 396; *New Zealand Payroll Software Systems Ltd v Advanced Management Systems Ltd* [2003] 3 NZLR 1. For a useful summary of the principles governing assignability see the judgment of Finn J in *Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd* [2006] FCAFC 40, para 32.

[12] [1994] 1 AC 85 at 108.

[13] *Caldy Manor Eestate Ltd v Farrell* , above, n 10, citing *Coke upon Littleton*, vol II, p 206b. Some statutes have gone even further and provided that if moneys due under a contract are assigned in breach of the statutory provision then while the assignment is in itself effective the moneys assigned become forfeited. See below, n 15.

[14] There is a passage in Lord Browne-Wilkinson's speech which might be thought to suggest that the contract rights never passed to the assignee at all, even as between assignor and assignee (see p [1994] 1 AC 85 at 108), and see the principle stated in similar terms in the judgment of Anderson J in *New Zealand Payroll Software Systems ltd v Advanced Management Systems Ltd* [2003] 3 NZLR 1 at paras 27 and 28. But it is clear that in both cases the issue was whether the assignment was effective *against the debtor* and it was held that because of the prohibition of assignment the debtor was under no obligation to recognise the title of the assignee. The distinction between effects as against the debtor

Salmond J many years ago in the New Zealand decision *Holder and Tolley Ltd v Cornes.*[15]

> "It is contended, however, that the assignment is invalid as being in breach of the prohibition of assignment contained in the contract between the defendant and the Crown. It is true that by so assigning without the consent of the Post-Master General the moneys payable under the contract the defendant committed a breach of her contract with the Crown. It does not follow from this, however, that the assignment is invalid and inoperative as between assignor and assignee."

The point is of particular importance where the assignor becomes insolvent after collecting the debt and before transferring the proceeds to the assignee. If the assignment were void even as between assignor and assignee the assignor's trustee in bankruptcy or liquidator would be able to retain the proceeds as an estate of the estate even though the assignor had already received the consideration for the assignment. The estate would thus be unjustly enriched while the assignee would be left to prove as an unsecured creditor. Recognition of the efficacy of the assignment as between the parties avoids this unjust result without causing any detriment to the debtor. The assignor is trustee of the proceeds and it or its trustee in bankruptcy or liquidator can be required to hand them over to the assignee.

One can put the general principle more broadly. A no-assignment clause not only has no effect in the relations between assignor and assignee but also has no impact on the outcome of competing third-party claims to the assigned debt. So if there are two assignments, the first of which is prohibited and the second permitted, the first in time nevertheless prevails.[16] Similarly the assignee under an assignment

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and effects as against third parties was well brought out many years ago by Bob Allcock, "Restrictions on the assignment of contractual rights" [1983] 42 CLJ 328.

[15] [1923] NZLR 876 at 878. The judge went on to hold that while the assignment was effective the moneys assigned became forfeited to the Crown.

[16] Allcock, above, n 14, at 333-334, citing *Fortunato v Patten* 41 NE572 (1895) and *Martin v National Surety Co* 57 S Ct 531 (1937). See also G J Tolhurst, "The Efficacy of Contractual Provisions Prohibiting Assignment" [2004] Syd L Rev 8.

that is prohibited nevertheless has priority over a party subsequently obtaining a garnishee orer against the assignor.[17]

I would note *en passant* that the need to distinguish the relationship between debtor and creditor from that between creditor and assignee arises not only in substantive law but in the conflict of laws. The differentiation between the two relationships was not very sharply delineated in Article 12 of the Rome Convention on the law applicable to contractual relations but the draft Regulation ("Rome I") prepared by the European Commission to replace the Convention draws a very clear and welcome distinction. Article 13(2) makes all matters that would affect the debtor subject to the law applicable to the debt; Article 13(3) deals with priority conflicts and applies the law of the assignor's place of business. That is clearly the right approach, though some Member States of the European Union have taken a different position and argued for the application of the law governing the receivable even to priority conflicts, an argument which seems to me to be based on the misconception that the debtor's obligation is to pay the party having the strongest title to the debt, whereas the true position is that the debtor is not concerned with this and can pay the original creditor unless and until he receives notice of assignment.

Construction and effect of a no-assignment clause

The effect of a contract term by which a party undertakes not to assign his rights is in the first instance a matter of construction of the clause itself. This could be a mere personal undertaking having no effect on the validity of the assignment, with a breach sounding only in damages; a stipulation that the assignment is to be ineffective against the debtor without affecting relations between assignor and assignee *inter se*; a

[17] *Hodder & Tolley Ltd v Cornes* [1923] NZLR 876; *Attwood & Reid Ltd v Stephens* [1932] NZL" 1332.

purported bar even on the transfer of ownership of the right or its fruits as between assignr and assignee; or a stipulation the breach of which is to entitle the debtor not merely to recover damages but to terminate the contract.[18] The first and last of these alternatives is unlikely to occur in practice.[19] The intention of the debtor will usually be to procure the result of the second alternative, but the contract may be framed in terms which purport to render an assignment void altogether.

There are three different ways in which a legal system may deal with a no-assignment clause of this last kind. At one extreme the law may treat the clause as rendering the assignment void even as between assignor and assignee; at the other, it may hold it ineffective even in the relations between debtor and assignee, leaving the debtor only with a claim for breach of contract; or it may adopt an intermediate position and regard the assignment as precluding the assignee from suing the debtor while regarding it as effective as between the assignor and the assignee. While at the international level there is a marked trend in favour of leaving the assignee's rights against the debtor unaffected by the prohibition against assignment,[20] English law currently appears to adopt the intermediate position.[21] A prohibition against assignment thus has the effect that the debtor is not obliged to deal with anyone other than the assignor and may ignore a notice of assignment, with the consequence that:

(1) he may continue to pay the assignor;

(2) he cannot be sued by the assignee in the latter's own right;[22]

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[18] See "Inalienable Rights?", above, n 8, at 554, in a passage approved by Lord Browne-Wilkinson in *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85 at 104-105.

[19] *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*, above, n 11, *per* Lord Browne-Wilkinson at 104.

[20] See below, p 23.

[21] See text and n 26 below. For the Law Commission's proposal to move to the second position, see below.

[22] This is not the same as saying that the assignee may not be a claimant, merely that he may not be the substantive claimant. See the discussion of the *Vandepitte* procedure below, pp 16-19.

(3) where he is engaged in mutual dealings with the assignor he may continue to set off cross- claims against the latter even if arising after the date he received notice of assignment;[23]

(4) the rule in *Dearle v Hall* governing the priority of competing equitable assignments[24] does not apply and priority will go to the first assignee.[25]

It will be observed that all these effects are limited to relations with the debtor or, in case (4), notice to the debtor. The underlying principle is that the debtor cannot be affected by notice of a prohibited assignment, but that is as far as the principle goes. The prohibition cannot operate to prevent the assignment from transferring ownership of the debt to the assignee. English courts have yet to rule firmly on the point, but all the indications are that they are moving in that direction.[26]

A contractual prohibition on assignment may be overridden by statute.[27]

Scope of a no-assignment clause

What is the scope of a no-assignment clause? Does it prohibit equitable as well as statutory assignments? Does it extend to declarations of trust and to equitable charges? Does it embrace the sum received by the assignor from the debtor? These are all questions of construction of the contract. Prima facie a clause precluding assignment

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[23] Contrary to the usual rule that an assignment destroys mutuality and precludes the set-off of cross-claims arising after receipt of notice of assignment.

[24] Under the rule in *Dearle v Hall* (1828) 3 Russ 1 a later assignee who takes without notice of the prior assignment but is the first to give notice to the debtor obtains priority over the earlier assignee.

[25] See above, p 8.

[26] See in particular *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, *per* Lord Browne-Wilkinson at 108; *Barbados Trust Ltd v Bank of Zambia* [2007] 1 Lloyd's Rep 495, *per* Waller LJ at para 47; *per* Rix LJ at para 112; *Hendry v Chartsearch Ltd* [1998] CLC 1382, *per* Millett LJ.

[27] *Co-operative Group (CWS) Ltd v Stansell Ltd* [2006] EWCA 538.

covers equitable as well as statutory assignments,[28] and includes mortgages as well as sales and gifts, but does not extend to declarations of trust[29] or equitable charges[30], neither of which constitute a transfer of rights. A declaration of trust creates an equitable interest rather than transferring one (though it has to be admitted that the distinction is a rather fine one), while a "mere" charge (that is, a charge which does not incorporate an agreement for a mortgage) is simply an encumbrance, a *ius in re aliena*, and does not operate as a transfer of rights.[31] Again, a clause prohibiting assignment of a debt will not ordinarily be construed as prohibiting assignment of the collected proceeds in the hands of the assignor[32]; and a clause purporting to cover such proceeds should be treated as of no effect, for quite apart from the fact that a contract between debtor and creditor cannot regulate the proprietary effects of a transfer from the creditor to an assignee the debtor can have no legitimate interest in seeking to control the application of the proceeds, for once he has paid the debt he is out of the picture.[33]

Qualified prohibitions on assignment

The most draconian form of no-assignment clause is that which simply prohibits assignment. Most clauses, however, provide that a party cannot assign his rights without the other party's prior written consent, but may add that such consent is not to be unreasonably withheld. In such a case the assignment is ineffective against the

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[28] *Barbados Trust Co Ltd v Bank of Zambia* [2007] 1 Llod's Rep 495, per Waller LJ at para 34; *R v Chester Legal Aid Office, ex parte Floods Ltd* [1998] 1 WLR 1496, *per* Millett LJ at 1501.
[29] *Ibid.*; *Re Turcan* (1888) 40 ChD 5; *Defevi Pty Ltd v Mateffy Pearl Nagy Pty Ltd* [1993] RPC 493 at 505.
[30] However, everything depends on the construction of the contract, and thecircumstances may show that the parties intended "charge", which is a term often used interchangeably with "mortgage", to include a mortgage. A charge which includes an agreement for a mortgage is an equitable mortgage and constitutes a transfer. A mere charge unaccompanied by such an agreement does not.
[31] Roy Goode, *Legal Problems of Credit and Security* (3rd edn), para 1-51.
[32] *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85; *Re Turner Corp Ltd* (1995) 17 ACSR 761.
[33] "Inalienable Rights?" (1979) 42 MLR 553 at 555.

debtor if consent is not requested, and it is no answer that had it been applied for it could not reasonably have been refused.[34] It is not uncommon for a clause prohibiting assignment to permit assignments within the group of companies to which the assignor belongs (though even here consent may be dependent on the assignee beingof at least equal credit standing) and assignments resulting from a consolidation, amalgamation or merger. It is a question of construction whether a clause prohibiting assignment covers involuntary assignments and other assignments by operation of law as well as contractual assignments.

III DECLARATIONS OF TRUST AND CHARGES

Should a no-assignment clause be extended to declarations of trust and charges?

A failed assignment clause may be treated as a declaration of trust.[35] Those drafting no-assignment clauses have tended either to overlook declarations of trust and equitable charges or to assume that because these do not involve assignment they cannot prejudice the debtor anyway. This last assumption is false. There is in fact no good commercial reason for distinguishing declarations of trust or equitable charges from equitable assignments in the drafting of such clauses. In the first place, an equitable assignee, like a trust beneficiary or equitable chargee, has no direct right of action against the debtor, who is thus no more prejudiced by an equitable assignment than by a declaration of trust or charge. In the second place, where there is no prohibition against a declaration of trust or a charge notice to the debtor of the declaration of trust or charge operates to preclude the debtor from setting off against

[34] *Hendry v Chartsearch Ltd* [1998] CLC 1382.
[35] *Barbados Trust Co Ltd v Bank of Zambia* [2007] 1 Lloyd's Rep 495, *per* Rix LJ at para 77; *Explora Group plc v Hesco Bastion Ltd* [2005] EWCA 646.

the latter's claim cross-claims arising after receipt of the notice,[36] in just the same way as notice of assignment. It therefore behoves the debtor to extend the prohibition so as to cover declarations of trust and fixed and floating charges.[37]

Effect of declaration of trust not covered by no-assignment clause

In *Re Turcan*[38] it was held that a covenant to settle after-acquired property covered policies of life asssurance even though these were expressed to be non-assignable. The covenant operated as if it had been a declaration of trust, so that while the trustees of the settlement could not themselves have received the policy moneys from the insurers they could claim the benefit of them when received by the insured's estate. It is clear from the judgment of Cotton LJ that though the court was concerned with the proceeds of the policies after payment, it considered that the policies themselves were subject to the trust during the settlor's lifetime.

A declaration of trust of contract rights was thus seen primarily as emabling the beneficiary to collect the proceeds from the trustee, and while the decision in *Re Turcan* showed that the trust would operate even before collection of the policy moneys there was until recently no case in which the facts raised

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[36] *Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 1 WLR 578. The effect, if any, of notice of an equitable charge on the account debtor's duty to pay is a question of remarkable obscurity, on which there appears to be neither case law nor discussion in the literature. It is thought that just as notice of the charge precludes set-off of any future claim against the chargor (see above, n 5), so also the debtor can no longer safely pay the chargor, since the payment would destroy the chargee's security interest. On the other hand it would also appear that until the chargee has become entitled to enforce the charge the debtor cannot pay the chargee either, for this would extinguish the chargor's equity of redemption when he is not in default. Once the debtor has received notice of the chargee's right to enforce the charge he would seem to be obliged to pay the chargee, but cannot, in the case of a mere charge, be compelled to do so except in proceedings in which the chargor is joined as claimant or, if unwilling so to act, as defendant. In this respect the chargee is in the same position as an equitable assignee.

[37] While the dealing power given to the debtor company enables the debtor to maintain a set-off even of cross-claims arising after receipt of notice of the charge (*Business Computers Ltd v Anglo-African Leasing Ltd* [1977] 1 WLR 578), notice of crystallization puts an end to the eligibility for set-off of future cross-claims (*ibid*), so it is important to include floating charges in the prohibition. A prohibition on charges is best covered by a more general provision prohibiting the grant of security interests.

[38] (1888) 40 ChD 5.

the need for resort to a trust of the debt itself without impermissibly involving the debtor. Then came the much-discussed decision of Lightman J in *Don King Productions Inc v Warren*,[39] the facts of which were as follows:

> The plaintiff and the defendant entered into a partnership agreement for the management and promotion of registered boxers. The agreement provided for the assignment of earlier management and promotion contracts despite the fact that these constituted prohibitions against assignment. Subsequently a new partnership agreement was entered into providing for all such existing and future contracts to be held on trust for the partnership. The partners undetook not to be engaged in any business carried on by the partnership otherwise than through the partnership. Nevertheless one of the partners later entered into another agreement for his own benefit, whereupon the remaining partners instituted proceedings for breach of the partnership agreement and subsequently dissolved the partnership. The defendant contended, among other things, that the effect of the prohibition against assignment was to limit the interest of the partnership to a trust of the receipts coming into the hands of the would-be assignor prior to dissolution of the partnership, and that the benefit of the non-assignable contracts could not be "property" for the purposes of the Partnership Act 1890. Rejecting this argument, Lightman J said:
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> "Accordingly in principle I can see no objection to a party to contracts involving skill and confidence or containing non-assignment provisions from becoming trustee of the benefit of being the contracting party as well as the benefit of the rights conferred. I can see no reason why the law should limit the parties' freedom of contract to creating trusts of the fruits of such contracts received by the assignor or to creating an accounting relationship between the parties in respect of the fruits."[40]

This statement was approved by the Court of Appeal, which upheld the decision.[41] Addressing the argument that a non-transferable right could not constitute property, Morritt LJ drew attention to cases in which it had been held that while a transfer could not affect the party who imposed the prohibition against assignment there was no

[39] [2000] Ch 291.
[40] *ibid* at 321.
[41] *ibid* at 327. For criticisms of the decision see P G Turner, "Charges of Unassignable Rights" (2004) 20 JCL 1 and Andrew Tettenborn, "Trusts of unassignable agreements" [1998] LMCLQ 498.

reason why, as between partners, the right could not be treated as partnership property.[42]

A further argument that had been advanced by the defendant before Lightman J was that to allow a person to declare himself the trustee of a non-assignable contract would defeat the object of the no-assignment clause since it would enable the beneficiary, if the trustee refused to enforce the contract, to sue for enforcement himself, joining the trustee as defendant, under the procedure laid down in *Vandepitte v Preferred Accident Insurance Corporation of New York.*[43] This argument too was rejected. If a party wished to prohibit a declaration of trust he should stipulate this expressly, which had not been done in the instant case. Moreover, the courts would not allow the *Vandepitte* procedure to be used in a commercial context where it had no place to abrogate the protection the other party had secured for itself by the terms of the contract from intrusion by thirc parties. In any event, where, as in the instant case, the trust was an active trust under which the trustee had duties to perform, the beneficiary was not entitled to terminate the trust under the rule in *Saunders v Vautier*[44]and intervene.[45]

Despite this, the *Vandepitte* procedure would have been successfully invoked in *Barbados Trust Co Ltd v Bank of Zambia*[46] but for the fact that, in the view of the majority, there had been no valid assignment to the party making the declaration of trust. In that case a differently constituted majority of the the Court of Appeal

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[42] See *Pathirana v Pathirana* [1967] AC 233 (assignment of personal licence to partnership); *Ambler v Bolton* (1872) LR 14 Eq 427 (inalienable government contract held partnership property).
[43] [1933] AC 70 at 79.
[44] (18410 Cr & Ph 240.
[45] To this one could add that in the case of an active trust the giving of notice of the beneficiary's interest achieves nothing, for the trustee remains entitled to perform his management functions and to deal with the trust assets free from the beneficial interest. By contrast in a bare trust a debtor who has notice of the beneficiary's interest ceases to be entitled to make payment to the trustee.
[46] [2007] 1 Lloyd's Rep 495.

(Hooper LJ dissenting) held that even if the prohibition against assignment had been extended to cover a declaration of trust (which it had not in that case) the beneficiary would still be entitled to compel the trustee to enforce the contract and for that purpose to join the trustee as defendant if it was not willing to act as claimant. Admittedly the facts in that case were rather peculiar, but the statement of principle by the majority is sound.

> The Bank of Zambia had borrowed money pursuant to a facility one of the terms of which was that the debt should be assignable to a bank or other financial institution but only with the Bank of Zambia's prior written consent. The original creditor of record was acknowledged by all parties as being Masstock (International Ltd) and in a series of assignments the debt was traded on the distressed debt market. Masstock sold the debt to Bank of America, which purported to sell it to GMO Emerging Country Debt LP. However, GMO was not a bank or other financial institution. The ultimate assignee was the claimant, Barbados Trust Co, but since its title was derived through a party that was not a bank or other financial instrument and was thus disputed on that, as well as other grounds, Bank of America executed a declaration of trust in favour of the claimant, who chose to rely on this instead of the assignment derived through GMO. There had been no prohibition of a declaration of trust
> The claimant,which was not itself a bank or other financial institution, sought to have proceedings instituted for its benefit by its assignor, Bank of America, which, however, declined to do so, for reasons which were not clear but were possibly based on commercial sensitivity. Thereupon the claimant invoked the *Vandepitte* procedure, issuing proceedings against the Bank of Zambia and joining Bank of America, the trustee of its claim, as defendant.
>
> There was a dispute whether the necessary consent had ever been given to the assignment to the Bank of America, and a majority of the Court of Appeal held that it had not, so that the claim failed. The question was whether, if the assignment had been valid, the claimant would have had a right to sue despite the fact that it would have had only a beneficial interest in the debt, not legal title. The defendant contended that the declaration of trust was equivalent to an equitable assignment and therefore itself required the defendant's consent, which had not been sought or given. This contention was rejected. The defendant further argued, relying on the judgment of Lightman J in the *Don King* case, that to allow use of the *Vandepitte* procedure in the instant case would be to do the very thing that the consent requirement was designed to avoid, namely to expose the defendant to a claim by a party it had not recognised. The Court of Appeal held by a majority that the claimant would have been entitled to invoke the *Vandepitte* procedure, since although the Bank of America as trustee was nominally the defendant it was in reality the substantive claimant and was entitled to judgment.

In reaching its decision the majority emphasized the policy considerations. First, the Bank of Zambia plainly owed the money. Why should the Bank of America's refusal to sue be allowed to deprive the claimant of the money to which it was entitled, and the recovery of which involved no intervention in the relationship between the defendant and the Bank of America? Why should the defendant be permitted to escape payment? Second, there was a strong public interest in promoting alienability.

> "It seems to me that there is a tension between (a) the interests of those whose contracts, either because they are of an inherently personal nature or because of agreed restrictions on alienability, should not readily be intruded upon by strangers to them, (b) the interests of those who seek to arrange their affairs on the basis of holding property in trust for others, and (c) the public interest, which is concerned to see that contracts are performed, that the beneficiaries of trusts are protected, and that financial assets are not too readily made inalienable especially where markets regularly provide liquidity for the trading of them. If a prohibition on assignment carried all before it, destroying all alienability whatever the circumstances, even to the extent of making it impossible for beneficial interests to be protected in any circumstances in the absence of the legal owner as a formal claimant, it seems to me that the public interest in freedom of contract and the freedom of markets could be severely prejudiced."[47]

The court also pointed out that there was nothing about the underlying contract of a personal nature, and the *Vandepitte* mechanism was a purely procedural device designed to avoid the multiplicity of actions that would ensue if the claimant first had to sue the Bank of America to compel it to bring proceedings against the defendant and the Bank of America then had to bring separate proceedings against the defendant.[48] The claimant was not entitled to a judgment in its own favour, only to have judgment rendered in favour of its trustee, the Bank of America, who would then have to hand over the fruits. It is clear that the court regarded the Bank of America as the true claimant for the purpose of the proceedings and that, but for the lack of

[47] *ibid, per* Rix LJ at para 112.
[48] *Ibid, per* Waller LJ at para 47.

consent to the assignment, it would have been entitled to recover the full amount of the debt even though it had ceased to be the beneficial owner.[49]

In short, use of the Vandepitte procedure does not expose the debtor to paying anyone other than the original creditor or affect his defences or rights of set-off against the original creditor. It is, of course, true that where the assignor undertakes as a term of the assignment or later agrees to bring proceedings against the debtor the assignor ceases to be a free agent in his relations with the debtor, who may thus be exposed to a more rigorous enforcement of payment than it might have expected from the original creditor. But that by itself is not a sufficiently significant consideration to require that two sets of proceedings be instituted instead of one. Again, if the debtor were to insist not only on prohibition of an assignment or declaration of trust but also on an undertaking by the assignor not to sue for the benefit of the assignee, that would be tantamount to making the debt inalienable, contrary to the common law rule against restraint on alienation, for why would anyone purchase a debt which he was unable to recover?

Barbados differed from *Don King* in two important respects. First, the case was a dispute between trustee and beneficiary and did not involve the other party to the contract. Second, the trust in *Don King* was an active trust, whereas the trust in *Barbados* was a bare trust under which the beneficiary was entitled to intervene under the rule in *Saunders v Vautier* and force the trustee to collect payment.

[49] Applying the principle established in the *Linden Gardens* case, above, n ...

Effect of charge not covered by no-assignment clause

Where the creditor does not assign the debt but merely charges it, there is no transfer to the chargee, onlyly an encumbrance in his favour which constitutes a right *in rem*. However, the problem confronting the chargee is the same as that confronting the equitable assignee, namely that since his interest is purely equitable he cannot institute proceedings in his own right but must rely on the chargor to do so or, if the latter refuses, bring proceedings himself in right of the chargor, joining the latter as defendant in accordance with the *Vandepitte* procedure. The reasons for allowing the procedure to be invoked in case of a non-prohibited declaration of trust apply equally to a non-prohibited charge. The chargor, though not formally a trustee, is in the position of a trustee to the extent that his interest has been charged, and should be able to be joined in the proceedings in the same way as where there has been a declaration of trust.

Effect of prohibition of both assignment and a declaration of trust and charge

Suppose that the agreement between debtor and creditor prohibits not merely an assignment but a declaration of trust. Does this preclude use of the *Vandepitte* procedure? The argument in favour of an affirmative answer is that if the trust is not validly created there is no scope for the procedure to operate. However, as with assignments, it is necessary to keep in mind the central principle, that bars to assignment or other dealing are relevant only to the relationship with the debtor, not to the relationship between the parties to the dealing in question. Just as it is not competent to the debtor to exclude by contract the proprietary effects of an assignment as between assignor and assignee, so also the debtor cannot effectively exclude the creation of a trust operative as between trustee and beneficiary. The most

he can do is to insist that he will not recognise the title of the beneficiary or the ability of the beneficiary to bring proceedings in his own right. The debtor cannot, however, object to proceedings by the assignee *in right of the assignor*, the procedural mechanism provided by the *Vandepitte* procedure to ensure that the assignor's rights are enforced so as to make the fruits available to the assignee. That, indeed, was the view of the majority of the Court of Appeal in *Barbados*, who saw no distinction in this respect between a prohibition against assignment and a prohibition against a declaration of trust. Similar considerations apply to a charge of the debt by the creditor.

The above discussion assumes a need to resort to the *Vandepitte* procedure in the first place. However, there seems no reason why this cannot be obviated by appropriate contractual provisions in the assignment.[50]

IV DRAFTING CONSIDERATIONS

The above analysis has implications for the drafting both of no-assignment clauses and of assignments. A no-assignment clause should be extended to prohibit charges and declarations of trust. An assignment should include (1) a declaration of trust both of the contract rights themselves and of the proceeds (on the basis that while these may be ineffective against the debtor that are valid as between the parties and in relation to third parties), (2) the right of the assignee to require the assignor to bring proceedings against the debtor for the benefit of the assignee, and (3) a power of attorney to the assignee to bring such proceedings itself in the name of the assignor.[51]

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[50] See below.

[51] Prior to the Judicature Act 1873 the common law did not recognise an assignment of a chose in action, and this problem was overcome by conferring on the assignee a power of attorney to bring proceedings in the name of the assignor (see *Three Rivers District Council v Bank of England* [1996]

IV BY-PASSING THE NO-ASSIGNMENT CLAUSE

The simplest way of surmounting a no-assignment clause is, of course, to avoid an assignment. We have seen that where the contract does not preclude a declaration of trust this may be used without infringing the prohibition against assignmen, and the same is true of a mere charge, that is, a charge which does not include an agreement for a mortgage. Another method of avoiding a no-assignment clause is by means of a synthetic transaction. For example, whilst a true securitisation of mortgage-backed assets involves a transfer of assets, typically to a special-purpose vehicle, a synthetic securitisation leaves ownership of the assets with the originator while the credit risk is passed to a protection seller, eg by means of a credit-linked note which reduces on default or a credit default swap.

V POLICY REASONS FOR OVERRIDING THE NO-ASSIGNMENT CLAUSE

The no-assignment clause works well enough where the creditor wishes to assign only a single receivable or a limited number of existing receivables. It also has a role to play in relation to dealings in derivatives, where the preservation of mutuality is seen as important in order to preserve the efficacy of close-outs and netting. But the clause plays havoc in the field of general receivables financing, where a continuing stream of receivables is to be assigned, as is the case with the factoring of trade debts to a factoring company. It is wholly impracticable for the factor to examine each of the underlying contracts to see if it contains a no-assignment clause; and what is the factor to do if it discovers that the debts are unassignable? No doubt in practice,

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QB 292). In *Warner Bros Records Inc v Rollgreen Ltd* [1976] QB 430 this procedure was referred to by Roskill LJ at 444 as "very often" adopted. Its advantage is that it avoids the need to join a reluctant assignor as defendant.

factors manage by securing waivers from the major debtors or incorporating an express declaration of trust of the proceeds in the factoring agreement[52] or by relying on warranties and by reserving a right of recourse in respect of debts improperly assigned. But such devices should be unnecessary. It needs to be borne in mind that in a supply contract containing a no-assignment clause it is the debtor who is likely to be in the stronger bargaining position and thus to be able to impose a prohibition on assignment against the supplier. The debtor is also in a position to refuse to give security for payment. The unsecured supplier wishing to offload its risk by assigning its receivables to a factor is therefore placed in an impossible position. Similar problems arise in relation to fixed and floating charges of existing and future receivables and assignments of receivables in project finance or by way of securitisation. In each case to allow a no-assignment clause to be effective against the chargee or assignee constitutes a serious impediment to the free flow of receivables in the stream of trade.

It was the Americans who, always more concerned with business efficacy than with concepts, were the first to identify the adverse effects of permitting the debtor to insulate himself from an assignment of a payment right by a no-assignment clause. In his great work *Security Interests in Personal Property* the late Professor Grant Gilmore put the matter in characteriscally trenchant style:

> "The position taken here is in favour of the unrestricted and unrestrictable alienability of contract rights. To rehearse social and economic arguments designed to prove that the position is sound would not be helpful. On propositions of so fundamental an order belief is instinctive and irrational, not logical and reasoned. Freedom of contract cuts both ways: to the freedom of a debtor to restrict or prohibit transfer of claims against him may be opposed the freedom of a creditor to transfer rights whose attested by the fact that the transferee is willing to pay for them or lend money on their security. The

[52] *Salinger on Factoring* (4th edn), paras 9-38 and 9-39.

> social or economic utility of permitting creditors to transfer rights is believed to outweigh the utility of permitting obligors to forbid the transfer."[53]

What is now § 9-406(d) of the Uniform Commercial Code builds on common law developments in recognising the impediment to trade created by no-assignment clauses and, with some exceptions, robustly overrides them in favour of the assignee. To similar effect is Article 6(1) of the 1988 UNIDROIT Convention on International Factoring.

> "The assignment of a receivable by the factor to the supplier shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment."[54]

Likewise Article 9(1) of the 2001 UN Convention on the Assignment of Receivables in International Trade:

> "An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the assignor's right to asign its receivables."[55]

Even more interestingly, civil law jurisdictions have also been moving in this direction. Thus prohibitions against assignment of debts have been overridden in France and Germany and, as regards assignees taking without knowledge of the prohibition, in Italy, Japan, Spain and Switzerland,[56] and in England a similar rule has been proposed by the Law Commission as regards assignments of receivables.[57] These developments bear out Grant Gilmore's thesis that it is more important to protect freedom of commerce than freedom of contract.

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[53] Grant Gilmore, *Security Interests in Personal Property*, vol I, p 212.
[54] To accommodate sensitivities as to protection of the debtor, Article 6(2) excludes the application of Article 6(1) where at the time of conclusion of the contract of sale the debtor is situated in a Contracting State which has made a declaration under Article 18.
[55] Like §9-406(d) of the UCC, Article 9(1) is subject to various exceptions.
[56] See Georges Affaki, Chronique de Droit Bancair International, No 112, March-April 2007.
[57] *Company Security Interests* (Law Com No 296, Cm 6654, 2005), para 4.40.