Receivables Financing – A fresh look

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Introduction

Receivables financing, also known as invoice financing and supply chain financing, has had somewhat of a renaissance in recent years as businesses look to alternative forms of financial accommodation following the GFC. Previously often regarded as “lending of last resort” (often due to its similarity with debt factoring), businesses now recognise that receivables financing can provide efficient and competitive financing particularly to businesses which deal with a trading partner that has a stronger credit.

Around the same time that receivables financing was emerging as a mainstream form of financing, the Personal Property Securities Act 2009 (Cth) (PPSA) changed some of the fundamental aspects of the legal mechanics underpinning the financing arrangements. This paper examines the nature of receivables financing and considers how the PPSA has affected these transactions.

I WHAT IS RECEIVABLES FINANCING?

At its core, receivables financing is the sale of a debt owing to a business to give that business funds in advance of when it would otherwise expect to receive payment. As a debt is a chose in action, the transfer of ownership from the seller to the financier is made by way of assignment. Under the sale arrangement, the business assigns the debt to a financier in consideration of receiving early payment of an amount equal to that debt less a discount. The discount amount will be determined by a number of factors, including the credit worthiness of the obligor and the length of time between when the debt is sold and when it is due. Upon assignment the financier obtains the right to receive payment in full of the debt at maturity. Figure A below outlines the basic structure of a receivables purchase arrangement.
Of course, particular aspects of receivables financing transaction will vary from deal to deal. For example, in some transactions, recourse to the seller may be limited to the occurrence of certain events (generally fraud or a commercial dispute occurring between the seller and obligor)\(^1\) or alternatively, the financier may have full recourse to the seller; similarly, the obligor will be aware that the financier has purchased the receivables in some transactions and in others it will be undisclosed.

### A Receivables finance distinguished from other debt assignments

Receivables financing is only one reason that a business might assign a debt. Other common commercial transactions involving debt assignment are:

- (a) by grant of security;
- (b) debt factoring; and
- (c) securitisation.

### 1 Security

A business may grant security over a debt to secure payment or performance of an obligation it owes to a financier either as part of an all assets security (eg under a general security deed) or specifically over its book debts. In *National Westminster Bank plc v Spectrum Plus Limited and Ors*\(^2\), Lord Hope identified assignment of a debt to the secured party as one way to ensure that a security interest over those debts would be treated as a fixed charge.\(^3\) The benefit of a security interest being so classified is that the secured property is not available to satisfy amounts owing to preferred creditors, whereas property secured by a floating charge would be.\(^4\) The assignment of a debt may also occur where the grantor defaults under the terms of the financing arrangement and the secured party takes steps to enforce its security interest over the debt.

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\(^1\) Confusingly, receivables purchase transactions in Australia which are described as “no recourse” are often actually “limited recourse”.

\(^2\) [2005] UKHL 41 (*Re Spectrum Plus*).

\(^3\) Ibid at paragraph 54.

\(^4\) This was the context of the decision in *Re Spectrum Plus*. See 175(2)(b) of the *Insolvency Act 1986* (UK). In Australia, this was also the case prior to operational commencement of the PPSA (see s.433 and s.561 *Corporations Act 2001* (Cth)). An analogous regime applies in relation to security interests over circulating assets in the PPSA environment.
In a receivables financing transaction, the assignment of the debt by the seller to the financier is treated as a "true sale": it does not secure payment or performance of an obligation. Where a receivable is assigned by way of security, the grantor retains a right to have the debt re-assigned to it under its equity of redemption. This is contrasted with receivables financing transactions where the seller retains no equity of redemption in the debt. In certain circumstances, the seller may request that a financier re-assign a purchased receivable to it but the receivables purchase agreement would usually restrict this to circumstances where the seller may be liable to indemnify the financier under its right of recourse or where the receivable has been diluted (e.g., in connection with a commercial dispute or where the obligor has exercised a right of set-off in connection with the purchased receivable).

2 Debt factoring

Debt factoring has been described as:

The purchase of debts ... for the purpose of providing financing or relieving the seller from administrative tasks or bad debts, or for any or all of such purposes.\(^5\)

Like receivables financing, debt factoring involves a seller assigning a debt to a financier on a "true sale" basis. While there is no single structure for debt factoring, there are two significant ways in which debt factoring usually differs from receivables financing:

- (a) **all vs selective assignment:** debt factoring will usually involve the sale of all present and future receivables\(^6\) (or in the case of facultative factoring, in batches) whereas receivables financing is done on a selective basis per invoice and so is a sale of present receivables; and

- (b) **discounting of receivables:** debt factors do not normally pay a discount to face value of the receivable. Instead, factors earn fees by charging interest on withdrawals from the factoring account into which they deposit an initial advance of the debt (usually between 70% to 90% of its face value). Once the debt is paid, the factor will deposit the balance into the factoring account less fees for administrative services (such as collecting the debt). The factor will usually require that a certain dollar amount or percentage of debts outstanding is retained in the factoring account at all times.

3 Securitisation

Securitisation involves the sale of a pool of debt obligations (which may or may not be secured) to a special purpose vehicle which funds the acquisition by issuing securities such as bonds or notes and sells them to investors. The obligations sold by the business which owns the debts (known as the

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\(^6\) As it is not possible to presently assign a future chose in action, the assignment in respect of future debts will usually be structured as an agreement to assign and the interest of the assignee will attach automatically to the debt once it comes into existence. For a detailed discussion of this issue, see AG Guest, *Guest on The Law of Assignment*, (2012) Sweet & Maxwell at 3-22.
originator) are usually payable in instalments which will generate the income stream on the bonds or notes for the investors. In contrast, the debt purchased by a financier in a receivables financing transaction will be a single debt arising under a specific invoice or purchase order so it will not generate a future income stream.

**B Why do receivables financing?**

There are a number of benefits of receivables financing transactions which make them attractive to both businesses and financiers.

1 **Benefits for businesses**

The primary benefits for businesses are set out below:

(a) **Access to liquidity:** receivables financing allows businesses improved access to liquidity by reducing ‘days sales outstanding’ (the period from when the invoice is issued to when the business receives payment) and helps to accelerate the cash conversion cycle.

(b) **Improved balance sheet management:** the sale of receivables will usually be characterised as an off-balance sheet transaction\(^7\) rather than a debt obligation. By diversifying funding sources, businesses also have an improved capacity for debt reduction where more cash is received which is not required for debt cover obligations. Typically, sellers will sell receivables at the end of financial quarter to receive a lump sum of cash on their balance sheets.

(c) **Reduced financing costs:** receivables financing is typically utilised by businesses which deal with a strong obligor that is able to extend payment terms due to its dominant market position. The discount to face value of the invoice is calculated on the obligor’s credit worthiness (which is typically stronger than the business’) and results in lower financing costs than the business would incur for a working capital facility.

(d) **Risk management:** in limited recourse transactions, the business is able to protect against an obligor’s payment default and insolvency risk as the receivable is assigned to the financier with no recourse to the business if the obligor does not pay the purchased receivable.

(e) **Eliminate early payment discounts:** as businesses no longer need to encourage early payment by obligors, they are able to remove any early payment discounts which may often be more than the discount to face value on the purchased receivable. The corollary of this is that it also allows businesses to offer attractive extended payment terms to their customers.

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\(^7\) Whether a transaction meets the requirements for an off-balance sheet transaction will usually be determined by the seller’s auditors. Different auditors adopt different views. Whether a transaction is limited recourse is one factor that auditors have regard to in determining the appropriate balance sheet treatment.
2 Benefits for financiers

The benefits available to financiers include:

(a) **higher ROE:** when compared with debt finance, receivables financing typically has a better return on equity. Most portfolios will have a ROE of 15% or greater and receivables financing at the lower end of the market can have a ROE of over 80%.

(b) **self-liquidating:** the financier’s exposure is a self-liquidating, short term exposure which has end-to-end controls and processes in place.

(c) **lower price elasticity:** receivables financing provides an annuity income to the financier with a more consistent pricing range when compared with other forms of sales financing.

(d) **relationship:** receivables financing transactions assist financiers in becoming a strategic partner to assist businesses in managing their supply chain financing arrangements and can help to position financiers for other financing requirements.

C Risks in receivables financing

Receivables financing transactions are usually regarded as lower risk than debt as the financier’s credit exposure is to an obligor which will often have a stronger credit than the business selling the debts. Accordingly, the risk of insolvency exposure is reduced and is priced in to the discount to face value calculated by the financier. However, there remain a number of other risks which may need to be addressed in the receivables purchase agreement, namely:

(a) **fraud:** this is generally considered to be the most significant risk in a receivables financing transaction and may occur where a business has issued false invoices to obtain the benefit of immediate financing or where the business has purported to sell the same receivable to another financier. This risk is usually addressed by providing recourse to the seller (including in limited/no recourse transactions) where fraud occurs and may be further mitigated by proper due diligence of the supply contract between the business and the obligor.

(b) **commingling:** in some transactions (typically where the sale of the receivables is undisclosed to the obligor) the obligor will pay the amount owing for the debt into the business’ operating account where it is commingled with funds owned by the business rather than an account controlled by the financier. A business may request this so as to avoid disruption to their cash management arrangements and invoicing procedures. Unless notice of the assignment has been given to the obligor, payment into the business’ account will be sufficient to discharge the payment obligation. In these circumstances the financier is exposed to the risk that the business becomes insolvent before the proceeds are paid to the

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8 An account controlled by the financier may be in its name or a management account in the name of the business selling the receivable.
financier and those funds are treated as the business’ assets and are available to its creditors. As the funds have not been held separately, it is likely to be difficult to establish that they are held on trust for the financier. This risk is assessed on a case by case basis and where a financier agrees to commingling, is usually addressed by requiring the business to transfer funds received in relation to the purchased receivable by no later than the following business day and the financier establishing a settlement limit on the business.

(c) dilution: this occurs where the obligor pays less than the full value of the debt on the maturity date as a result of any rebates, discounts, commercial disputes and set-off arrangements. This will usually be identified through due diligence and priced into the discount to reflect historical dilution rates. The receivables purchase agreement may also provide for recourse to the business in these circumstances. The risk is significantly reduced where the sale is by way of a legal assignment and notice is given to the obligor on day one. This is because the obligor’s right to discount the debt as a result of any prior equities between the business and the obligor ceases upon it receiving notice of the assignment.9

III ASSIGNMENT

As identified already, assignment is the legal mechanism by which a business sells its debts to a financier. Indeed the importance of assignment is perhaps given expression by one commentator who noted:

If we were asked—who made the discovery which has most deeply affected the fortunes of the human race? We think, after full consideration, we might safely answer—The man who first discovered that debt is a Saleable Commodity.10

Traditionally, assignment has been done on a legal or equitable basis although in many respects, the importance of the distinction has been eroded by the PPSA.

A Pre-PPSA position: legal vs equitable assignment

Prior to the Judicature Act 1873 (UK), the common law did not recognise an assignment of a chose in action. This meant that for an assignee to be able to enforce an assigned debt against the obligor, the assignee would need to get the assignor to bring the action in its own name, or if the assignor refused, the assignee could seek an injunction compelling the assignor to allow its name to be used to enforce the legal right. By the time of the Common Law Procedure Act 1854, an action at law was permitted to allow the assignee to commence proceedings in its own name and join the assignor as either a co-plaintiff or co-defendant (determined by whether the assignor was willing to join the action or not).11

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9 See s.80(1)(b) PPSA. Note, however, that the notice must comply with the requirements in s.80(7) for it to be effective. See page 10 for further discussion.

10 HD Macleod, Principles of Economical Philosophy, 2nd edn (1872) at 481. See also Guest above n 6 at 1-04 (note, however, that the quote is incorrectly attributed to “IH Macleod”).

11 See discussion on “Equitable Assignments of a Legal Chose” in Guest above n 6 at 3-07ff for a considered history.
Following the introduction of s.25(6) of the Judicature Act 1873, where the requirements of the section were met an assignee became the legal owner of the debt entitling the assignee to sue the obligor in its own name. Importantly, the section also provided that the assignee obtained the power to give good discharge for the debt without reference to the assignor. This meant that if the obligor paid the assignor, it would nevertheless remain liable to the assignee for the debt. From a practical perspective, this encouraged payment directly to the assignee which reduced the risk that an assignor would fail to pass on moneys received in relation to the assigned debt.

Section 25(6) of the Judicature Act 1873 was repealed and re-enacted in s.136 of the Law of Property Act 1925 and the same principles have been incorporated into Australian law. In this respect, the expression "legal assignment" may more aptly be described as a "statutory assignment".

For an assignment to be treated as a legal assignment, the following conditions need to be satisfied:

(a) the assignment must be in writing under hand of the assignor;

(b) the assignment must not be by way of charge only; and

(c) express notice in writing must be given to the debtor.13

1 The importance of notice

One of the reasons why legal assignment has traditionally been preferred over an equitable assignment in receivables financing is that giving notice to the debtor effectively kills two birds with one stone: aside from allowing the assignment to be characterised as a legal assignment, thereby giving the assignee the right to enforce the debt directly, notice to the debtor was effective to establish priority under the rule in Dearle v Hall.14

Dearle v Hall may perhaps be considered the assignment equivalent of the classic fairytale, The Three Little Pigs. In an over-simplified summary of the case, a young man received a legacy under his father’s will which he found was insufficient to meet the expenses of his lifestyle and he purported to assign his right to £37 of his annual payment of £93 to Assignee A for £204. Assignee A took no steps to notify

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12 See s.134 Property Law Act 1958 (Vic), s.12 Conveyancing Act 1919 (NSW), s.199 Property Law Act 1974 (Qld), s.20 Property Law Act 1969 (WA), s.15 Law of Property Act 1936 (SA), s.86 Conveyancing and Law of Property Act 1884 (Tas) and s.182 Law of Property Act (NT) (collectively, “assignment statutes”).

13 See for example, s.12 Conveyancing Act 1919 (NSW) which provides:

Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal chose in action, of which express notice in writing has been given to the debtor, trustee, or other person from whom the assignor would have been entitled to receiver or claim such debt or chose in action, shall be, and be deemed to have been effectual in law (subject to all equities which would have been entitled to priority over the right of the assignee if this Act had not pass) to pass and transfer the legal right to such debt or chose in action from the date of such notice, and all legal and other remedies for the same, and the power to give a good discharge for the same without the concurrence of the assignor: Provided always that if the debtor, trustee, or other person liable in respect of such debt or chose in action has had notice that such assignment is disputed by the assignor or anyone claiming under the assignor, or of any other opposing or conflicting claims to such debt or chose in action, the debtor, trustee or other person liable shall be entitled, of he or she thinks fit, to call upon the several persons making claim thereto to interplead concerning the same, or he or she may, if he or she thinks fit, pay the same into court under and in conformity with the provisions of the Acts for the relief of trustees.

14 (1828) 3 Russ. 1. Although this case dealt with competing equitable assignments of an equitable chose in action, it has subsequently been extended to equitable assignments of legal choses in action, such as debts: see Gorringe v Irwell India Rubber and Gutta Percha Works (1887) 34 Ch D 128.
the executors of the assignment but registered a memorial of the assignment with the High Court of Chancery. Assignee A may be likened to the little pig who built his house out of straw. Not content with his £204, the young man agreed to assign his interest in £27 of his annual legacy to Assignee B for the sum of £150. Assignee B also took no steps to notify the executors of the assignee but registered a memorial of the assignment with the High Court of Chancery. Assignee B may be likened to the little pig who built his house out of sticks. Apparently the young man’s funding of £354 from hapless investors was still not sufficient to sate his financial requirements and he subsequently purported to assign all of his interest in the legacy for £711 to Assignee C. Prior to entering into the assignment, Assignee C contacted the executors of the estate and requested information about the fund and the young man’s title to the legacy. Having received satisfactory responses, he entered into the assignment. Shortly after doing so, Assignee C served written notice on the executors requiring them to pay the annuity instalments to him. Assignee C did not register a memorial of the indenture with the High Court of Chancery. As may be anticipated, Assignee C may be likened to the pig who built his house out of brick.

When Assignee A and Assignee B were not paid, they wrote to the executors requesting that they be paid on the basis of their prior assignment. The High Court of Chancery held that their prior assignments were not enough to defeat Assignee C who had established priority by giving notice of the assignment to the executors. To extend the metaphor, the notice of assignment created a brick house which was able to resist the huffing and puffing of earlier assignees.

For these reasons, it can be seen that a legal assignment has been historically preferred by receivables financiers as it allows the financier to enforce directly against the obligor and is a means by which to fix priority.

**B  Position under the PPSA**

In many respects, the historical distinctions between legal and equitable assignment are less relevant in receivables financing under the PPSA. This is because the PPSA essentially creates a regime which addresses both the priority issue and the circumstances in which the assignee can enforce payment of the purchased debt against the obligor directly. However, as identified below, some inconsistencies remain and given that s.254 of the PPSA states that the Act is not intended to exclude or limit the operation of any law of the Commonwealth, State or Territory or the general law to the extent that the law is capable of operating concurrently with the PPSA, it is anticipated that the prior law of assignment as it relates to receives financing will continue to be of some relevance.\(^{15}\)

1 **Priority**

In a fundamental change to the prior general law position for which the PPSA is justifiably notorious, the PPSA treats the outright sale of a receivable as a security interest. Section 12(3)(a) of the PPSA

\(^{15}\) For example, the PPSA does not modify the position that it is not possible to presently assign a future receivable.
provides that a security interest includes “the interests of a transferee under a transfer of an account or chattel paper”.16 This applies even where the sale of the receivable does not secure payment or performance of an obligation but is, instead, a true sale.17 The Act provides a detailed definition of “account” which, in practical terms, will apply to receivables in most circumstances; however, care should be taken where there are back to back assignments of receivables (eg where a subsidiary assigns its receivables to its parent company and the parent company assigns those receivables to a financier) to determine the PPSA treatment for each assignment.18

Accordingly, the priority rules contained in s.55 of the PPSA apply with the effect that priority will usually be determined by the time that the security interest is perfected and not the time that the obligor is notified of the assignment. It should be noted, however, this only establishes priority as between the assignee and other creditors of the assignor; it does not establish priority as between the assignee and other creditors of the debtor and in most instances, the assignee will remain an unsecured creditor unless it is otherwise able to avail itself of a security in relation to the purchased receivable.

Accordingly, the question of notice is no longer relevant in determining priority and it is possible for a subsequent equitable assignment of a debt to have priority over an earlier legal assignment of the same debt if the equitable assignee has perfected its security interest by registration on the Personal Property Securities Register first. Professor John Stumbles has considered many combinations and permutations of equitable and legal assignment and perfected and unperfected security interests in a recent article which brings into clear focus how the PPSA inverts the paradigm of the prior law priority rules.19

Another aspect of the PPSA which affects priority relates to the assignor’s power to deal with receivables which it has previously sold. Even in situations where the assignor has assigned the receivable absolutely, the priority provisions of the PPSA contemplate that the assignor continues to have a residual power to assign the receivable. For example, a subsequent assignee may obtain priority ahead of a financier under a receivables purchase agreement if the subsequent assignee perfects its security interest in the assigned debt ahead of the original financier. This may particularly be the case if a financier delays registration so as to ensure that it has the benefit of the priority regime under s.64. In his article, Professor Stumbles has described the position as: “The PPSA has thus

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16 “Account” in this context means an account receivable and should not be confused with a bank account which is referred to as an “ADI account” under the PPSA. The New Zealand Act overcomes this confusion by referring to it as an “account receivable” in its legislation: see s.16(1) Personal Property Securities Act 1999 (NZ).

17 Note that the PPSA only treats the absolute assignment of “accounts” and “chattel paper” as a security interest for the purposes of the Act. The PPSA will not apply to the assignment of other choses in action unless the assignment in substance, secures payment or performance of an obligation.


19 Ibid.
created, by implication, a significant new exception to the *nemo dat [quod non habet]* rule, despite the absence of specific language in the statute to this effect.”\(^{20}\)

2 Direct enforcement

Under the PPSA, providing notice of the assignment to the obligor remains the way in which an assignee is able to enforce payment directly and in this respect, there is no change from the prior law position. Sections 80(7) and (8) PPSA provide:

(7) If an account or chattel paper is transferred, the account debtor may continue to make payments under the contract to the transferor:

(a) until the account debtor receives a notice that:

(i) states that the amount payable or to become payable under the contract has been transferred; and

(ii) states that payment is to be made to the transferee; and

(iii) identifies the contract (whether specifically or by class) under which the amount payable is to become payable; or

(b) after receiving a notice under paragraph (a) (other than a notice from the transferor), if:

(i) the account debtor requests the transferee to provide proof of the transfer; and

(ii) the transferee fails to provide proof before the end of 5 business days after the day of the request.

(8) Payment by an account debtor to a transferee in accordance with a notice under paragraph (7)(a) (including in circumstances described in paragraph (7)(b)) discharges the obligation of the account debtor to the extent of the payment.

It will be noted that there are some differences between the requirements in s.80(7) and (8) of the PPSA and the assignment statutes and there remains some uncertainty as to which aspects operate concurrently with the PPSA and which cannot. For example:

(a) the PPSA includes a requirement to identify the contract under which the amount payable is to become payable, whereas there is no corresponding requirement in the assignment statutes. While from a practical perspective a notice to the debtor may commonly include this information, it is not required for a legal assignment. It is submitted that where the PPSA applies to the assignment of a debt\(^{21}\), the Act evinces an intention to establish the requirements for notice to the debtor and accordingly, it seems likely that a legal assignment

\(^{20}\) Above n 17 at 457.

\(^{21}\) For example, the PPSA does not apply to the transfer of an account to satisfy a pre-existing indebtedness (s.8(1)(f)(viii)) or as part of a sale of business (s.8(1)(f)(ix)). Section 80(7) of the PPSA will also not apply to the assignment of other choses in action to which the assignment statutes will continue to apply.
which complies with the relevant assignment statute will not permit the assignee to enforce directly against the debtor if it does not also identify the contract giving rise to the debt.

(b) section 80(8) of the PPSA indicates that payment by the debtor to the assignee discharges the obligations of the debtor to the extent of the payment; however, unlike the assignment statutes, it makes no mention of it being without the concurrence of the assignor. This creates the possibility that the power to give good discharge is not solely vested in the assignee so that payment to the assignor may also discharge the obligation. Without express words to indicate otherwise, however, it seems likely that Parliament’s intention was to keep the position as it was under the existing assignment statutes so that although the PPSA is silent on the subject, only payment to the assignee will discharge the debtor’s obligation. This is further supported by the wording in section 80(1) which refers to prior equities arising “before the first time when payment by an account debtor to the transferor no longer discharges the obligation of the account debtor under subsection (8)”. In this respect, the PPSA and the assignment statutes operate concurrently.

(c) each of the assignment statutes includes a provision which entitles the debtor to pay the amount of the debt into court where there are opposing or conflicting claims and the debtor is unable to determine who to pay; under the PPSA, there is no corresponding provision and this priority dispute would be determined in accordance with the priority rules set out in the Act, usually determined by registration time. Again, the statutory assignment provisions seem capable of operating concurrently with the PPSA so it is likely that a debtor would still be able to pay the debt into court while the dispute was resolved. This would also help to relieve the debtor of any consequences for late payment arising under the contract.

It should also be noted that a disclosed receivables financing transaction does not always mean that there has been a legal assignment of the debt. Many receivables financing deals are structured as uncommitted facilities where the receivables are offered for sale on a selective basis and the financier is not obliged to purchase any of them. A seller or financier may prefer that the receivables financing is done on a disclosed basis and a notice of assignment is provided to the obligors at the time of entering into the receivables purchase agreement; however, where there is the possibility that the financier may not purchase all of the receivables, this notice is not sufficient to establish a legal assignment because it does not identify the debts being assigned to the financier. If a legal assignment is required as part of the transaction, separate notices identifying each purchased receivable would need to be provided. For this reason, some financiers may prefer to provide notice complying with s.80(7) PPSA only if there has been a payment default by the obligor when it wants to be able to enforce payment of the receivable directly. Of course, this exposes the financier to an increased risk of prior equities.

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22 Section 80(1) PPSA provides:

The rights of a transferee of an account ... (including a secured party or a receiver) are subject to:
arising between the date of assignment and the date of the notice but it may be a risk that the financier is prepared to take.

IV RESTRICTIONS ON ASSIGNMENT

It is common for supply contracts to contain a provision which restricts either or both parties from being able to assign all or part of their interest under the contract. The restriction may be qualified, as in where assignment is permitted with the prior consent of the other party, or it may be absolute. In the past, restrictions on assignment have created a number of obstacles for prospective receivables financing transactions which have in part been overcome by the PPSA.

A Pre-PPSA: Linden Gardens

Prior to the PPSA, the law relating to the effect of contractual provisions restricting assignment was the position outlined by the House of Lords in Linden Gardens Trust Limited v Lenesta Sludge Disposals Limited & Ors.23 In that case, the court held that "an assignment of contractual rights in breach of a prohibition against such assignment is ineffective to vest the contractual rights in the assignee".24 The court identified several reasons why the identity of the counterparty to a contract might be important to one or both of the parties to the contract and rejected an argument which suggested that the restriction should only apply to the right to future performance and not to accrued rights.25 With regards to the effect of a purported assignment in contravention of a contractual restriction vis-à-vis the assignor and the assignee, the court observed:

*a prohibition on assignment normally only invalidates the assignment as against the other party to the contract so as to prevent transfer of the chose in action: in the absence of the clearest words it cannot operate to invalidate the contract as between the assignor and the assignee and even then it may be ineffective on the grounds of public policy.*26

As always, the starting point for determining the scope and effect of any restriction on assignment is to consider the words used in the contract.27 In receivables financing transactions prior to the PPSA, it may still have been possible to effect an assignment despite a restriction on assignment if the proper construction of that restriction did not apply to the assignor or to the debt being assigned. Where the

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23 [1993] UKHL 4. Note that the case concerned the assignment of rights arising under a contract (rights of actions in proceedings the assignor had brought against a building contractor for breach of contract) rather than assignment of debts.
24 Per Browne-Wilkinson LJ at 16.
25 At 12.
26 Per Browne-Wilkinson LJ at 15.
27 N 23 above at 11. See also Goode, "Inalienable Rights?" (1979) 42 MLR 553.
proper construction of the provision did restrict assignment of the debt, alternative structures may have been available. For example, the business may have been able to declare a trust over the receivables purchased by the financier which would not offend the restriction; similarly, the business may have been able to enter into a back to back arrangement whereby it immediately paid the money it received from the obligor to the financier. The problem with these structures, however, was that the financier was reliant on the business to enforce the debts and had limited or no control over the process. In some circumstances, the business may have decided to equitably assign the debt to a financier notwithstanding the restriction. This did not overcome the effect of the restriction but merely made it less likely that the obligor would find out about it. From a financier’s perspective, however, it did not end up with title to the debt and in the event of default, would have recourse to the assignor only. Where the assignor was a higher credit risk than the obligor, this would increase the amount of the discount to face value charged which could affect the overall economic viability of the transaction. As a consequence, a restriction on assignment contained in a supply contract was usually fatal to a receivables financing transaction.

B PPSA

Section 81 of the PPSA introduces a new regime for restrictions on assignment as they apply to receivables financing transactions. The section provides:

(1) This section applies to a term in a contract if:

(a) the contract is between an account debtor and a transferor; and

(b) the term restricts or prohibits transfer of any of the following for currency due or to become due:

(i) the whole of an account that is the proceeds of inventory;

(ii) the whole of an account that arises from granting a right (other than a right granted under a construction contract), or providing services (other than financial services), in the ordinary course of a business of granting rights or providing services of that kind (whether or not the account debtor is the person to whom the right is granted or the services are provided);

(iii) the whole of an account that is the proceeds of an account mentioned in subparagraph (ii);

(iv) chattel paper.

(2) The term in the contract:

28 A potential avenue for financiers enforcing in these circumstances is under the “Vandepitte process” (Vandepitte v Preferred Accident Insurance Corp of New York [1933] AC 70) pursuant to which “a party to a contract can constitute himself a trustee for a third party of a right under the contract and thus confer such rights enforceable in equity on the third party. The trustee can then take steps to enforce performance to the beneficiary by the other contracting party as in the case of other equitable rights. The action should be in the name of the trustee; if, however, he refuses to sue, the beneficiary can sue, joining the trustee as a defendant.”
(a) is binding on the transferor, but only to the extent of making the transferor liable in damages for breach of contract; and

(b) is unenforceable against third parties.

1 Effect of s.81 on assignors

Section 81 makes it clear that where an assignor purports to assign a receivable in contravention of a prohibition on assignment in the supply contract, the restriction on assignment is binding on the assignor but only to the limited extent of making the transferor liable to damages to the obligor: it does not make the assignment ineffective. The NZ PPSA does not contain a comparable provision although the Uniform Commercial Code §9–406(d) (US) is similar and indeed is even more expansive than s.81. In addition to providing that a restriction on assigning an account, chattel paper or promissory note is ineffective, the UCC also goes on to state that a clause which provides that an assignment gives rise to a default, breach, right of termination or remedy is also ineffective. Even though the PPSA does not contain similar wording, it is submitted that the obligor would not be able to terminate the contract for breach of a material term (assuming that the no assignment clause could be characterised as such) as Parliament has limited the obligor’s rights to damages for breach. It also seems unlikely that an obligor would be able to claim that the assignment was a repudiation of the contract and purport to accept the repudiation.

Although s.81 does provide the obligor with a right to damages, the obligor must still establish that it has suffered loss in order to claim anything more than nominal damages. In the context of a receivables financing transaction, it is difficult to see what loss might arise. One possible ground for damages would be if the obligor had certain rights of set-off as against the assignor which it was no longer able to exercise after having received notice of the assignment; however, as the obligor still has a right to recover moneys owing to it from the assignor, it seems unlikely that the obligor will have suffered any loss. Further, s.80(1) expressly contemplates that the assignee of a receivable takes the receivable subject to the terms of the contract between the assignor and the obligor, including a defence by way of a right of set-off so the obligor may not be materially prejudiced in any event.

2 Effect of s.81 on assignees

While s.81 PPSA makes a contractual restriction on assignment unenforceable against the assignee, it does not protect an assignee against all claims which may be brought against it in connection with the breach. In particular, a receivables financier may be exposed to a claim that it has interfered with the contract between the assignor and the obligor giving rise to a claim in tort. However, for a claim to be successful, the obligor would still need to establish that the receivables financier’s intentional interference with its contractual rights caused damage.29 Further, as noted by Dixon J in James v The

Commonwealth\textsuperscript{30}, what amounts to inducement for the purpose of the tort is a “matter of some obscurity”. While the threshold for establishing that an assignee induced the assignor to breach its supply contract remains high, a prudent receivables financier will nevertheless be cautious about how it deals with assignors where there are restrictions on assignment. Given that the assignor remains liable to the possibility of damages, the assignor should assess its own risks in relation to the transaction rather than being induced by financial incentives offered by the financier.

V CONCLUSION

In taking a fresh look at receivables financing, it can be seen that the PPSA has had a profound effect on receivables financing transactions in Australia. In many respects, the position is simpler than it was under prior law with the distinction between legal and equitable assignment no longer as relevant as it once was; however, the PPSA itself introduces uncertainty with clarity required from either the courts or Parliament. Notwithstanding any uncertainty, however, receivables financing continues to be an increasingly popular form of financing which allows businesses to diversify their financing away from debt.

\textsuperscript{30} (1939) 62 CLR 339 at 371.