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FAQs on assignments in finance transactions

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This note aims to provide brief and practical answers to common questions on the law of assignment in English law finance transactions.

1. **Are all notified assignments legal assignments?**

   No, while all legal assignments must have been notified to the debtor, notice to the debtor is not enough by itself to make an assignment a legal assignment. The full requirements for a legal assignment are set out in the answer to question 2.

2. **What are the requirements for a legal assignment?**

   A legal assignment must comply with section 136 Law of Property Act 1925 (the **LPA**) in that it is:

   a. in writing and signed by the assignor;
   b. expressly notified to the debtor in writing – notice can come from the assignor or the assignee;
   c. not a charge;
   d. of the whole of the assigned right(s) – and not of a fraction or a percentage of the assigned right(s);
   e. a present assignment of existing property – rather than of future property, such as future rights to claim under an existing insurance policy or rights under a contract that has yet to be concluded;
   f. of legal rights, rather than of equitable interests (such as interests under a trust); and
   g. not conditional – including, because the assignee is entitled from the date the assignment is notified to the debtor to collect/receive and enjoy the assigned rights as they fall due for payment or performance.

3. **What practical difference does it make to the assignee whether an assignment is a legal assignment, or a notified equitable assignment?**

   There are two differences. The first is that an assignee suing the debtor under a legal assignment before the English courts has the right to sue the debtor in its (the assignee's) own name and without having to join the assignor in those proceedings as a co-claimant or as additional defendant. By contrast, in equivalent proceedings under an equitable assignment, the judge has a discretion to compel the assignee to join the assignor in those proceedings as a co-claimant or a defendant. However, this discretion is not always exercised in favour of joining the assignor.

The second practical difference is that a legal assignment is prima facie capable of being fully enforceable against the assignor as a property transaction and, as such, good against third parties, even if the assignee gave no value for its assignment. Again, by contrast, certain types of equitable assignment (e.g. assignments of future property) are not fully enforceable as property transactions that are good against third parties if the assignee gave no value for its assignment. This is because of the principle that "equity will not assist a volunteer". Here, equity requires actual value and this requirement is not satisfied by the assignee providing purely nominal consideration, or the assignment being made in a deed.

The other main practical benefits of having a legal assignment are broadly equally available to an assignee under a notified equitable assignment for value. These benefits are:

a. once the debtor has received notice of an absolute assignment, it must pay or perform the assigned rights in favour of the assignee;

b. notice to the debtor is capable of establishing the priority of the assignment over later notified or non-notified assignments under the rule in *Dearle v. Hall (discussed in questions 13 and 14 below)*;

c. notice to the debtor is capable of protecting the assignee from legal set-offs (a.k.a. mutual debt litigation set-offs) that the debtor has against the assigned rights from its dealing with the assignor and which arise after the debtor receives notice of assignment; and

d. notice to the debtor deprives the assignor and the debtor of their legal ability to terminate or amend the assigned rights to the detriment of the assignee.

4. Will a security assignment be a legal assignment if the notice to the debtor instructs it to continue to pay or perform in favour of the assignor pending a later notice that an event of default has occurred?

No, the ability of the assignor to continue to collect/receive and enjoy the assigned property pending the occurrence of a later event makes this sort of assignment conditional rather than "absolute". Conditional assignments do not come within section 136 LPA.

5. Our security document refers to a security assignment as an "absolute assignment". Is this correct?

A security assignment can and will be absolute if:

a. it is of the whole of each assigned right, and not of a portion, fraction or percentage of any assigned right;

b. the assignment is not conditional, because the overall effect of the assignment and the notice of assignment is that the assigned rights are the assignee's property from day-one and do not only become the assignee's property upon the later fulfilment of a condition (such as a notice from the assignee to the debtor that an event of default has occurred);

c. (as an aspect of the assignment not being conditional under b above) neither the assignment nor the notice of assignment allows for the debtor to pay or perform the assigned rights in favour of the assignor rather than the assignee; and

d. the assignment is not conditional in some other way.

6. Can a security assignment be re-characterised as a floating charge (and does giving notice to the debtor make any difference)?

Yes, a conditional security assignment, and some other security assignments, can be re-characterised as floating charges. Giving a notice of assignment to the debtor would not, by itself, prevent this re-characterisation.

More specifically, in ***Re Spectrum Plus Ltd (In Liquidation)*** [2005] 2 A.C. 680, Lord Scott said that a security document would create floating security if, despite its other features, it had the third feature of a floating charge identified by Romer LJ in *Re Yorkshire Woolcombers Association* [1903] 2 Ch. 284. This third feature is:

> *"if you find that by the charge it is contemplated that, until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business*

in the ordinary way as far as concerns the particular class of assets until some future step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the [assigned/charged] assets".

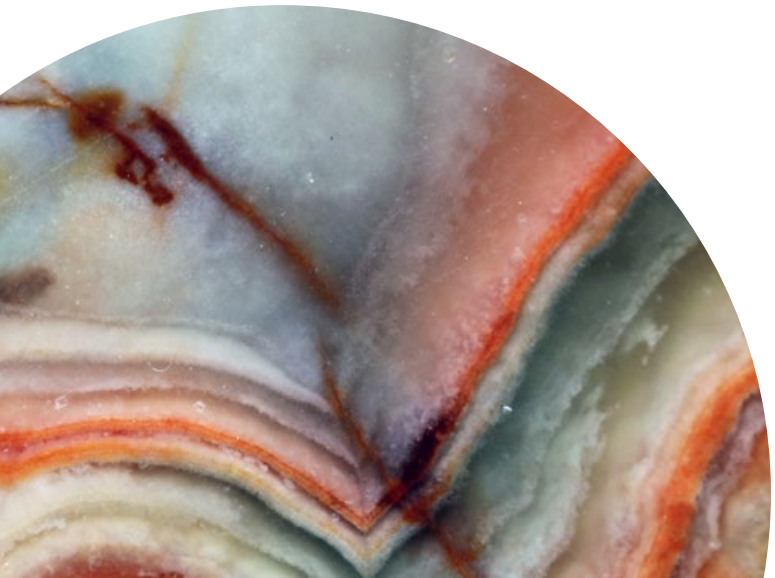
Applying this statement, where a security assignment allows the debtor to continue to collect or receive, and use and enjoy, the assigned property for its own purposes (rather than exclusively for the discharge of the secured obligations) that security assignment may be re-characterised as a floating charge.

If such an assignment were notified to the debtor, this would not prevent the assignment from being a floating charge, unless the notice had the effect of depriving the assignor of use of the assigned property on and from the assignment. In practice, such notices often instead provide for the debtor to continue to pay or perform the assigned rights in favour of the assignor pending a later notice from the assignee. This would be a notified security assignment, but liable to re-characterisation as a floating charge.

Alternatively, a security assignment might not be notified to the debtor, but provide that the assignor must remit all proceeds of all assigned rights to the assignee for those proceeds to be applied by the assignee exclusively to pay off the secured obligations. If the parties abide by this arrangement, this would be a non-notified security assignment, but it would not be a floating charge.

Even if a security assignment is drafted as an absolute, notified assignment it could still be liable to be re-characterised as a floating charge if, in practice, the assignee too readily and frequently releases some of the assigned rights or their proceeds from its security at the assignor's request.

Finally, re-characterisation of an assignment as a floating charge will rarely be significant outside UK insolvency proceedings.



7. Does the Assignment Agreement scheduled to the LMA's recommended form facilities agreements (the LMA Assignment Agreement) create a legal or equitable assignment?

Where a lender uses an LMA Assignment Agreement to dispose of its entire participation in a loan facility documented on LMA terms, the assignment is capable of being a legal assignment that meets the criteria set out under question 2.

Subject to the proviso below, where a lender uses an LMA Assignment Agreement to dispose of part of its participation in a loan facility documented on LMA terms, the resulting assignment will technically be an equitable assignment. This is because an assignment of part of a contractual right is not absolute under section 136 LPA.

The proviso is:

a. partly because of the rule in *Dearle v. Hall* (discussed in questions 13 and 14);

b. partly because of the way the LMA facility agreements are drafted; and

c. partly because the incoming lender's rights to collect or sue for payment direct from the obligors under the facility agreement do not just derive from the property law effects of its Assignment Agreement, but also derive from all relevant parties having agreed to the same contractual framework under the facility agreement and the incoming lender assuming obligations under that facility agreement,

there will almost always be zero practical difference between the effects of a partial equitable assignment, and an entire legal assignment, under an LMA Assignment Agreement. In particular, the priority of the assignment, whom the debtor (or obligor) is obliged to pay and the ability of the assignee, as an incoming lender, individually to bring legal proceedings under the Assignment Agreement

against an obligor without having to join the assignor in those proceedings, should almost always be the same under either assignment.

8. **Can an electronic assignment of receivables or other contractual rights effected via a dedicated online platform comply with the section 136 LPA requirements for an assignment to be in writing, signed by the assignor and notified to the debtor in writing?**

   In principle, yes. However, compliance with section 136 would depend in practice on how a particular electronic assignment were digitally documented, executed and notified in each case on the platform.

9. **Can an assignment of future receivables be an outright or true sale assignment?**

   Yes. An assignment of receivables that do not exist at the time of the assignment will always be an equitable assignment under English law. However, whether an assignment of receivables expressed as an outright sale is re-characterised as a secured loan does not depend on whether the sale is a legal assignment of existing receivables or an equitable assignment of future receivables.

   (Assignments of future receivables are not possible under the laws of some states.)

10. **If contractual rights cannot be assigned without the counterparty's consent, can consent be requested and obtained in the notice of assignment and acknowledgement exchanged with the counterparty?**

    No, if the assignment is to take effect as a property transaction that transfers title to the assigned rights to the debtor, it must do so when the assignment becomes effective.

    An assignment in breach of a prohibition on assignment, or of a personal right, to which (in either case) the counterparty has not consented, is usually void against the debtor (unless the judge finds the failed assignment takes effect as a trust). This voidness means that the assignment does not transfer the assigned rights to the assignee, or oblige the debtor to deal with the assignee in respect of those rights. On general principle, it is very unlikely that this voidness can be cured at a later stage by obtaining the counterparty's retrospective consent to assignment.

    However, where the counterparty has given its consent before the assignment takes place, we would usually record in the counterparty's acknowledgement of the notice of assignment that the counterparty had given that consent before the assignment took place.

11. **Will an assignment in breach of a prohibition on assignment contained in the contract generating the assigned rights always take effect as a trust?**

    No, an English court will not automatically interpret such an assignment as instead taking effect as a trust – particularly where there is no express, specific mention of a trust in the assignment. This is one reason why well-drafted security assignments tend expressly to provide that where an assignment is ineffective because of a prohibition on assignment, the assignment will take effect as a trust in favour of the secured party.

12. **Does a notice of assignment to the debtor prevent the debtor from asserting post-notice set-off rights it had against the assignor against the assignee instead?**

    No, notice of an assignment to the debtor only prevents the debtor from invoking one category of post-notice set-off that the debtor has against the assignor against the assignee. This type of set-off is known as legal or statutory set-off, or (more descriptively) mutual debt litigation set-off.

    Broadly, a mutual debt litigation set-off may arise when:

    a. the assignor and the debtor each have a debt claim against each other that is mutual;
    b. these debt claims arose before any notice of the assignment mentioned below;
    c. the assignor assigns its debt claim to the assignee;
    d. the assignee then sues the debtor for payment of the assigned debt;
    e. the debtor asserts a set-off against the assignee in the same action on the basis of the debtor's debt claim against the assignor
    f. both debt claims are due for payment at the start of the litigation and immediately before judgment; and

g. both debt claims succeed at the end of the litigation.

In this situation, the judge has a discretion to give the assignee a single net judgment for its debt claim, less the amount of the debtor's debt claim. Importantly, the judge has this discretion to set off the two claims even though there may be no connection between the two debt claims.

Among the post-notice set-offs **not** cut-off by notice to the debtor are:

a. contractual set-offs arising by agreement between the assignor and the debtor (for example, arising under a credit note issued by the assignor to the debtor as compensation for a previous breach of contract by the assignor);

b. equitable set-offs that are so closely connected to the assigned right that it would be manifestly unjust to allow enforcement of the assigned right without taking into account the debtor's set-off; and

c. abatement rights that reduce the amount of the price payable under the assigned right under section 53(1)(b) of the Sale of Goods Act 1979, or at common law.

13. What is the rule in *Dearle v. Hall* on the priority of assignments and does this rule determine the priority of both legal and equitable assignments?

The rule in *Dearle v. Hall* is that the priority of multiple assignments of the same right follows the order in which the debtor under the assigned right receives notice of those assignments.

Under this rule, subject to exceptions, an earlier notified assignment will have priority over later-notified assignments and non-notified assignments, regardless of when each assignment was created.

Yes, the rule in *Dearle v. Hall* determines the priority of both legal and equitable assignments. For example, under the rule, an equitable assignment taken a week after a legal assignment can have priority over that earlier legal assignment as long as the equitable assignment is notified to the debtor before notice of assignment is given under the legal assignment.

14. Are there any exceptions to the rule in *Dearle v. Hall*?

Yes, the rule in *Dearle v. Hall* does not enable the assignee under an earlier notified assignment to gain priority:

a. over an earlier created, but later notified or non-notified assignment, if the assignee under the earlier notified assignment did not give value for its assignment;

b. over an earlier created, but later notified or non-notified assignment, if the assignee under the earlier notified assignment had actual or constructive notice of the earlier created assignment when it took its own assignment or gave value for that assignment;

c. over a prior trust over the assigned rights; or

d. over a prior created but later notified assignment, where the assignee who first gave notice is a trustee in bankruptcy or a judgment creditor.

15. Following the *Mailbox* case, should security assignments of construction and project documents now be avoided?

In ***Mailbox (Birmingham) Limited v. Galliford Try Construction Limited*** [2017] EWHC 67, a contractor argued that a developer should not be able to sue it under a building contract between them because the developer had assigned its rights under the building contract to a security trustee under a debenture. Although the contractor lost the case, it did so on the basis that the security trustee had

validly assigned the contractual rights back to the developer before it made the claim. On the face of it, this might suggest that developers and project companies should avoid granting security assignments over rights that they may wish to enforce themselves at a later point, and instead only agree to grant a charge over such rights. Our experience is that some law firms are now advising their borrower clients to this effect on real estate development finance and project finance transactions.

However, in *Mailbox:*

a. the debenture required the security assignment to be notified to the contractor immediately following the assignment; and

b. both the debenture and the notice made clear that the security trustee became the party entitled to exercise all the assigned rights immediately on and from delivery of the notice (see paragraph 26 of the judgment).

Where such a notice has been given, it is not surprising that the counterparty would object to the assignor subsequently exercising those rights.

This is not how most security assignments of construction and project documents, nor the notices deliverable under them, are drafted. Some do not even require the assignment to be notified to the counterparty pre-default. Where they do require notice to be given immediately following the assignment, that notice usually expressly provides that the assignor may continue to exercise the rights under the assigned contract until the security holder gives notice to the counterparty that the security has become enforceable. In our view, provided a security assignment and notice are drafted on this basis, the assignment would not prevent the assignor from enforcing any rights under the contract before the security holder has given notice to the counterparty that the security has become enforceable.

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