

## **THE BUSINESS CONTRACT TERMS (ASSIGNMENT OF RECEIVABLES) REGULATIONS 2017**

- 1 This note on the Business Contract Terms (Assignment of Receivables) Regulations 2017 (**Regulations**) has been prepared by a working party of the Construction Law Committee (**CLC**) of the City of London Law Society (**CLLS**). The members of the working party deal with the issues raised in this note on a day-to-day basis.
- 2 The purpose of the note is to endorse the content and conclusions of the note on the Regulations dated 13 October 2017 and submitted by our colleagues on the Financial Law Committee (**FLC**) of the CLLS and to highlight a number of construction-focussed considerations which arise as a result of the Regulations.
- 3 In overview, in addition to the comments made by the FLC we consider that the Regulations, if they are adopted in their current form, have the potential adversely to affect:
  - access to finance and investment (other than receivables finance) for UK development infrastructure and construction businesses and for UK-based projects; and
  - construction outturn costs and deal flows.

### **Conflict with Construction and Infrastructure Finance**

- 4 We anticipate that some developers and project financiers are likely to be concerned about an inability to contract against receivables financings at main contractor level.
- 5 Prohibitions and restrictions on assignment (including assignment of receivables) are common in construction contracts – they feature in a number of well-used UK standard forms, such as the JCT suite of contracts, as well as previously published Government GC works contracts. Moreover, it is standard market practice in debt and bond financed deals to ensure that such restrictions are present in the main construction contracts.
- 6 The logic for restricting assignment is that developers (and investors in and lenders to developments) wish to ensure that the money they are spending/investing/lending goes to the subcontractors and suppliers actually carrying out the work on a given project (and not, for example, to another financial institution that has taken an assignment of receivables). Indeed there must also be governmental, quasi-governmental and charitable institutions that need to ensure that government and grant money is dedicated to be spent on an approved project and not diverted. Finance from bodies such as Export Credit Agencies may be strictly contingent on compliance with eligible content/sourcing requirements at subcontract level.
- 7 The Regulations create a direct challenge to main construction contract controls seeking to address these legitimate concerns.

## Construction legislation

- 8 The focus of construction industry payment legislation<sup>1</sup> has been to ensure prompt payment to contractors and subcontractors for the benefit of the whole contracting chain. The Regulations will apply to a number of contracts which do not fall under the scope of that payment legislation, although certain exclusions are very similar. By preventing restrictions on assignment of receivables in main/large contracts, it may be argued by some that this could disrupt cash-flows within projects.
- 9 One possible consequence of the Regulations therefore, could be to increase interest in direct subcontractor payment rights and/or project bank accounts. Although Government policy has been firmly behind such mechanisms, this has assumed that cash-flow margins lost are not simply replaced elsewhere in a pricing model. A further potential consequence of such models is that main contractors will not be willing to take responsibility for subcontractors for whom they do not receive payment (again, often a key requirement of construction lenders and investors).

## Set-Off

- 10 Construction contract payment processes can be quite varied but, as a general rule, employers are typically keen to preserve wide set-off entitlements and contractors and subcontractors do likewise in subcontracts. Indeed, whilst UK construction legislation has regulated the process for withholding from payments to prevent abuses, it has never sought to limit entitlements to do so and arguably enshrines these rights. The potential risks to an employer's right to set off/withhold payments has been the other principal reason given for prohibiting assignment and is therefore an obvious area of concern with the Regulations.
- 11 Should the Regulations constrain or create uncertainty in relation to set-off rights, for example, in relation to critical liquidated damages regimes or defect rectification remedies, this could impact on employers' (and their funders') risk analysis. Arguably it could even have adverse implications for the size and nature of performance security (e.g. retention or bonding), where legitimately required on a project. Generally, larger bonding requirements mean both greater outturn costs for employers, who typically pay their contractors their bond costs, and less flexibility for contractors whose ability to take on multiple projects will be fettered by having more of their bonding capacity tied up on fewer projects.
- 12 It would certainly cause issues for the unaware if an effect of the Regulations was to compromise the ability of payer entities to make withholdings and pay less when otherwise entitled to do so. It would be even more unfortunate if a further consequence of the Regulations were to be the reversal of the general thrust of policy and trends on retention and bonding, if cautious employers seek liquid security to address a possible loss of set-off rights.
- 13 The interface between the Regulations and the UK construction legislation would also need to be considered. The UK construction legislation establishes a requirement to serve pay less notices on payees (with the intention that prompt notice is given on any withholding). The payee is defined in the legislation as "... the person to whom the payment is due..." and so, we would assume, following any assignment, that would be the assignee. If pay less notices were to be served on the

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<sup>1</sup> Most notably, the Housing Grants, Construction and Regeneration Act 1996, as amended by the Local Democracy, Economic Development and Construction Act 2009.

assignee, this could potentially deprive the assignor of the prompt notification of a withholding intended by the relevant legislation.

### **Knowing the identity of the payee**

- 14 If there is the ability to assign receivables freely, the payer does not know then where the money is going to and/or has no say in to whom it is being paid. Where there are regulatory obligations on the payer to ensure that the money is not being used for money laundering operations or for bribery and corruption, these require that the payer has adequate procedures in place which he could not fulfil if he does not know who is receiving the money or how it is being used. The ability to withhold consent to the assignment at least gives the payer the ability to satisfy himself that he is complying with his adequate procedures.

### **Conclusion**

- 15 If adopted, our view is that the Regulations have the potential to create uncertainty and market disruption in a wide range of transactions in the building infrastructure and energy construction markets in the UK. Any benefit to smaller companies to access funds from invoice discounters would be outweighed by the uncertainty on set off and detrimental effect on other parts of the construction market.
- 16 We endorse the FLC's conclusion that the best outcome would be that the Regulations are not approved and that their terms are reconsidered, following proper consultation.

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Outgoing/incoming Chair

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