Non-Assignment Clauses and their Implications for Loan Agreements

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The essence of this article is to afford due consideration to the legal ramifications of an assignment of rights (insofar as it relates to loan agreements), effected by an "original" lender to an "incoming" lender, in circumstances where such an arrangement is invalidated vis-a vis the borrower, having been made in contravention of a non-assignment clause which is stipulated in the contract between the original lender and the borrower.

As a starting point, it might perhaps be worthy of mention, that a borrower may have convincing reasons for insisting on the inclusion of a non-assignment clause in an operative loan agreement. For instance, it may be that, from a personal or business perspective, the debtor is entirely comfortable with the particular creditor with whom he is transacting. Accordingly, it might thereby stand to reason that he would decline to consider the prospect of having to contend with anyone other than the existing lender himself. Indeed, in **Don King Productions Inc. v Warren (1999) 3 WLR 276**, this identity aspect, in the context of addressing assignment clauses, was a key consideration in a case concerning boxing promotion activities, and where the litigants, King and Warren, were leading promoters of the sport in the UK and USA respectively.

By the same token, in **Linden Garden Trust Ltd v Lenesta Sludge Disposal Ltd (19940 A C 85**, the identity of the contractor (Lenesta) was important to the employer (SCL) who, without the written consent of the former, duly assigned his contract (for the removal of asbestos) to one Linden, such assignment being contrary to a non-assignment clause in the applicable JCT standard form terms and conditions of contract. When Linden subsequently instituted a claim against Lenesta for breach of contract and negligence (in failing to remove asbestos from the designated site), the House of Lords, in addressing the effectiveness of the assignment, concluded, inter alia, that, under the circumstances, the particular contractual relationship between SCL and Lenesta, was such that it had to be preserved, and that accordingly, the non-assignment clause would thereby be regarded as valid and not against public policy.

At the other end of the contractual spectrum, a lender would be significantly more amenable to the incorporation of an assignment clause in the governing loan agreement (although, as will be seen later in this text, this proved to be counter-productive for BP Oil, whose standard term, non- assignment clause was implemented to its detriment), for it stands to reason that this could cater for any subsequent change in his financial, personal or other circumstances, necessitating the assignment of his rights to a third party (e.g. liquidity requirements).

In light of the foregoing, it is therefore arguable that the legal position concerning assignments may be such that it should seek a happy medium in accommodating

diametrically opposing interests which, on the one hand, respects the debtor's freedom to restrict the lender's right to assign, and on the other hand, sympathises with the latter's reasonable expectation that his proprietary rights are adequately protected, should the purported assignment fail. Indeed, it has been said that, in the final analysis, what it essentially boils down to, is pursuing a balanced legal approach which strikes a compromise between these conflicting positions (G McCormick, "Debts and Non-Assignment Clauses" (2000) JBL 438). This particular aspect will be one of the core issues which will emerge from the ensuing analysis.

A recent case which merits consideration and has contributed to casting further light on applicable legal principles governing assignments, is that of **National Bank of Abu Dhabi PJSG v BP Oil Limited (2016) EWHC 2892**, the facts of which are set forth below: BP entered into an agreement with a Moroccan refinery company, Societe Anonyme Marocaine de L'Industrie de Raffinage (SAMIR), to which it supplied Russian Urals crude oil. This was based on BP's'standard terms and conditions of contract which incorporated the following "Limitation of Assignment" clause:

"Neither of the parties to this Agreement shall without the previous consent in writing of the other party (which shall not be unreasonably be withheld or delayed) assign this Agreement or any rights or obligations hereunder. In the event of an assignment in accordance with the terms of this section, the assignor shall nevertheless remain responsible for the proper performance of the Agreement. Any assignment not made in accordance with the terms of this Section shall be void".

BP subsequently assigned, to the National Bank of Abu Dhabi (NBAD), 95% of the value of the debt/receivable which was owed by SAMIR as consideration for the supply of oil under the terms of their agreement (the value of the discounted payment being $68 million).

The operative letter of assignment provided for full repayment of the advance, plus interest, in the event of a breach of warranty.

The letter of assignment stipulated that BP was "not prohibited by ……any agreement from disposing of the receivable".

NBAD, as assignee, thereafter unsuccessfully sought to enforce the debt against the debtor/borrower SAMIR which was at the time, in a state of insolvency.

NBAD contended that, by virtue of BP's misrepresentation that it was entitled to effect the assignment, the latter was now itself under an obligation to pay NBAD the unpaid amount of the outstanding debt.

Despite an admission by the litigants themselves that the letter of assignment was a badly drafted document of randomly selected boilerplate clauses, the court held that it was nevertheless an assignment which thereby contravened the non-assignment clause contained in the initial contract between SAMIR and BP.

The key aspect of the case which was to be judicially addressed, was the resultant impact that the prohibited implementation of the non-assignment clause would have on the letter of assignment, as regards the contractual obligations that BP and NBAD had towards each other.

Whilst the case itself related to the assignment of a receivable, the court, per Carr LJ, put forward the following principles which would be equally applicable to assignments of loan participations:

- Contractual terms which in essence restrict assignment shall be regarded as valid and not contrary to public policy, as was made clear in Linden Gardens v Lenesta Sludge Disposals Ltd (19940 IAC 85, the facts of which were very briefly outlined above.
- Although contractual rights will not vest in the assignee in circumstances where a stipulated prohibition against assignment is breached, the contract between the assignor and assignee will not thereby be prejudiced. In this respect, the court cited Lord Browne-Wilkinson's judgment in Linden wherein he declared that "in the absence of the clearest words, it cannot operate to invalidate the contract between assignor and assignee.
- Where assignment is subject to the debtor's consent, such assignment ought not be unreasonably withheld. In this respect, any assignment effected prior to securing consent shall thereby be considered as irrelevant, irrespective of whether or not the debtor could have reasonably withheld consent **(Hendry v Chartsearch (1998) CLC 1382)**.

Although BP's position was that on a proper interpretation of the assignment letter they were not in breach of warranty as regards their entitlement to assign, the court ruled to the contrary and ordered the company to reimburse NBAD the full $68 million, plus interest. Paradoxically, the non-assignment provision which ultimately proved to be detrimental for BP, was in fact a key stipulation of one of its own standard terms of contract. In the final analysis, much of what transpired might well have been avoided if BP had obtained the requisite consent from SAMIR, prior to entering into the contentious/failed assignment arrangement with NBAD.

In the event that a breach of a non-assignment clause is occasioned by a purported assignment, the assignor could conceivably be obliged to account to the assignee for any proceeds he receives from the debtor **(Re Turcan (1889) 40 Ch. D 5).** According to R M Goode, this approach would be justified on the basis that once the creditor/assignor has the proceeds in hand, the debtor would thereby have no say in the matter ("Legal Problems of Credit and Security", 14th edition, 2009 para. 3-40). Commentators have been prompted to highlight the significance of this aspect in circumstances where the assignor becomes insolvent. In this event, the assignor's obligation to account, would effectively afford the assignee a priority claim in the insolvency, in respect of the outstanding amount in question (G McCormack "Debts and Non-Assignment Clauses" (2000) JBL 422).

A further legal mechanism which may work in the assignor's favour in the event of a failed assignment, is that put forward in **Don King Productions Inc v Warren (2000) Ch 291**, which would permit the original lender ("assignor"), to effectively declare a trust over the proceeds of the debt for the benefit of the new lender ("assignee"). In the Turcan case, Bristowe VC held that in circumstances where there was an agreement to assign a policy of insurance which incorporated a non-assignment clause, the assignor could effectively be regarded as trustee of the policy for the assignee. Accordingly, the insured in this particular case was duly regarded as the trustee of the policy proceeds for a third party.

Whilst the above approach has been criticised on the basis that the device of a trust did not, in essence, change the complexion of what was in reality an assignment, Turcan indicated that such an arrangement would, on the contrary, not go so far as to disrupt the lender-borrower relationship, for once the debt was paid to the original lender, the latter would be not obliged to explain to the borrower how he proposes to deal with the proceeds.

Whereas the declaration of a trust over the proceeds can be readily understood, a more problematic issue arises as to whether the original lender can declare a trust over the benefit of the contract as well. This aspect was addressed in Don King where Lightman J considered that this did not present any difficulties, as assignment and trusts were essentially different legal concepts. Although this view was subsequently the subject of criticism (in that it effectively eroded protection offered to borrowers who might seek to rely on non-assignment clauses), Lightman J considered the matter as being one of interpretation, and that *"whether the contract contains a provision prohibiting such a declaration of trust, must be determined as a matter of construction of the contract"*.

It is understood that the creation of a trust over the benefit of a contract will activate the so-called "Vandepitte Procedure", as derived from the case of **Vandepitte v Preferred Accident Insurance Corp of New York (1933) AC 70**, whereby a beneficiary of a trust (the assignee), would be at liberty to sue a third party (the debtor) and trustee (the assignor) as joint defendants. In effect, the upshot of this is that the incoming lender would be entitled to sue the borrower directly. This approach was subsequently favoured by the majority of the court, per Walter LJ and Rix LJ, in **Barbados Trust Co Ltd (formerly known as C I Trustees (Asia Pacific) Limited v Bank of Zambia and Bank of Americana (2007) EWCA Civ 14** (although Hooper LJ dissented on the basis that this was diametrically opposed to the prohibition against assignment). In the Barbados, the court saw no problem in permitting an assignee of rights under a syndicated loan, which embodied a non-assignment clause, to claim as beneficiary of a declared trust, directly from the borrower. It has been suggested however, that this decision should be narrowly regarded, by way of exception, as being restricted and applicable to its own particular facts, and that, as a general proposition it should, in such circumstances, be ordinarily incumbent on the borrower to effect payment only to the assignor as trustee, and not to the assignee as beneficiary *(E P Ellinger, E Lomnicka, C V M Hare," Ellinger's Modern Banking Law at p 876)*.

The upshot of the foregoing is that due care should be exercised by all parties to a loan arrangement, be they borrowers, lenders or assignees, to be vigilant in ensuring that, in the context of appreciating and understanding the nature and extent of their general contractual rights and obligations, there is also clarity as to the legal implications and potentially far-reaching consequences of assignments. Accordingly, in such circumstances, appropriate professional advice should be sought and obtained, in a prudent endeavour to avoid what might otherwise prove to be a costly and onerous outcome that might well have been averted.