

# To assign or not to assign – that’s a real question

When taking security over assets, often the default position for lenders has been to take an *assignment* over assets where they can, in preference to alternative forms of security such as a charge. However, as recent case law has shown, this is not always the most effective approach and can result in unintended consequences. In this briefing we discuss the legal and practical consequences of taking an assignment, the due diligence to be considered and the potential alternatives to assignments such as fixed and floating charges.

The recent decision in the case of *Dassault Aviation SA v Mitsui Sumitomo Insurance Co Ltd* [2022] EWHC 3287 (Comm) discussed the impact of contractual restrictions on assignment. The court upheld a prohibition on assignment in an English law sale contract. It follows the *Mailbox Case* in 2017 where the Court of Appeal found that a contract caught by the general assignment language in a security document was assigned absolutely to a funder, the effect of which could have meant the funder having to enforce the contract in its own name (unless it was re-assigned). These cases serve as a reminder to consider carefully whether an assignment is the preferred means of taking security.

## Differences between Assignments and Charges



### What is an assignment?

There are two types of assignment: legal and equitable.

**Legal assignments by way of security** involve a transfer of legal ownership, with a proviso for re-assignment on satisfaction of the secured liabilities. A legal assignment is only possible in relation to assets which already exist (this excludes future assets). A sum becoming due under an existing contract is regarded in law as an existing asset, even though the right to payment has not yet matured. Under the Law of Property Act 1925 (“LPA”), a legal assignment must:

- be in writing;
- be absolute and, in the case of a debt, of the whole (and not part only) of the amount owed;
- not purport to be by way of charge; and
- be notified to the contractual counterparties in writing.

**Equitable assignments** are essentially assignments that do not satisfy all of the requirements of the LPA. There are however differing views as to the effect of an equitable assignment of contractual rights:

- does it involve a transfer of ‘beneficial title’ in these rights; or

- is it a ‘trust’ – the assignor holds the contractual rights in equity for the benefit of the assignee.



### What is a charge?

There are two types of charge: fixed and floating.

**A fixed charge** creates an immediate proprietary interest in the charged asset in favour of the chargee but acts as an encumbrance on the charged asset; it does not transfer ownership and the ability to exercise contractual rights remains with the chargor. For a charge to be characterised as a fixed charge, the chargee must have the requisite level of control over the secured asset.

**A floating charge** generally ranks behind fixed security and hovers above a shifting pool of assets of the chargor. The chargor is permitted to deal with and dispose of the secured assets in the ordinary course of business. There will however be a mechanism for the charge to convert the floating charge into a fixed charge so that it may then exert stricter controls going forward (but will not obtain the priority position of a fixed security interest).



### What assets can be assigned?

Assigned assets are usually “choses in action” which are personal rights of property that can only be claimed or enforced by action, and not by taking physical possession. Assigned assets include intangible property such as:

- rights under contracts such as receivables, insurance policies and sale and purchase agreements;
- rights relating to investments; and
- credit balances.



### What assets can be charged?

Assets that are recognised as property and are capable of being transferred can be charged. This includes present and future property, and both intangible property (such as contracts, investments and credit balances) and tangible property (such as land, plant and machinery).



### Should you assign or charge?

The type of security a lender will take depends on various factors, including the nature of the relevant assets to be secured. In some instances, a lender may be better off taking a fixed charge instead of an assignment for legal and practical reasons. This is discussed below in the context of some of the key assets typically secured on a finance transaction.



### Credit balances (e.g. in bank accounts)

There is considerable doubt as to whether a lender can take an assignment over a cash deposit held with itself as account bank. The reason for this is that the lender would have to sue itself to recover the debt. It is generally considered to be possible and common practice instead for a charge to be granted (a so-called charge-back), and for a notice of the charge to be sent to, and acknowledged by, the account bank to demonstrate the requisite control.



### Contracts (e.g. rights under contracts, receivables and insurance policies)

- Contracts may contain an absolute prohibition on assignment, or a limitation on the number of permitted assignments (the latter being common in development documents).
- An assignee may be required to take direct action against a counterparty in order to pursue its rights under an assigned contract. This means a borrower cannot sue to recover any losses under an assigned contract, while the lender who does have the right to sue, will not have suffered the loss.
- With a charge, the chargor retains ability to exercise contractual rights, but the lender can control the conduct of the action.
- Where an assignment occurs but the assignor needs day to day control, the lender may need to licence back the contractual rights to the assignor, which a court may consider to

be inconsistent with the degree of control required for an assignment to operate as a fixed security interest.



### Investments (e.g. rights relating to shares)

- A legal assignment of shares may leave a lender exposed to the administrative burden and liabilities of being a shareholder, which lenders normally seek to avoid. From both parties' perspective, a charge is likely to be preferable in the ordinary course.
- A lender should seek specialist guidance before exercising voting and/or other share rights assigned or charged in its favour where the company has a defined benefit pension scheme or the National Security and Investment Act may apply.



### Conclusion – necessary due diligence

There are pros and cons with all types of security. The optimal security package for a lender requires careful consideration of the assets to be secured, the business of the borrower and the pitfalls associated with one type of security over another. A lender will also be interested in considering ancillary steps to optimise its security position such as contractual controls, ensuring perfection steps are taken and that security is registered in all appropriate registries. A borrower however will need to ensure the solution is one that is workable for its business, proportionate to the commercial debt terms and not unduly restrictive. In particular, parties should consider any “unintended consequences” that may arise from taking one form of security over another.

Lenders should not just require, nor borrowers accept, the “default” or “market” position as courts will not always uphold the “commercial intention” when the actual legal effect runs contrary.

## The Dassault Case

*Dassault Aviation SA (“Dassault”) entered into an English law governed sale contract to manufacture aircraft for Mitsui Bussan Aerospace Co Ltd (“MBA”) to supply to the Japanese Coast Guard. The sale contract included a no-assignment clause placing a restriction on assignment/transfer of rights under the sale contract without the prior written consent of the other party. MBA placed insurance to protect it from its liabilities for late delivery. The aircraft were delivered late and the Japanese Coast Guard claimed liquidated damages from MBA. MBA made a claim under its insurance policy. The insurer accepted the claim and paid MBA. Under Japanese insurance law, MBA’s claim against Dassault under the sale contract was transferred by operation of law to enable the insurer to bring proceedings in its own name against Dassault. The insurer submitted a request for arbitration, however, Dassault challenged jurisdiction on the basis the sale contract prohibited assignment/transfer of rights. The court supported the argument that the transfer to the insurer was prohibited by the no-assignment clause in the sale contract and found in Dassault’s favour, as whilst the claim was transferred to the insurer by operation of Japanese law, this was ultimately as a result of the voluntary placing of insurance by MBA.*

