

ASSIGNMENT

RIGHTS, DELEGATION AND NOVATION

PITFALLS AND ENFORCEABILITY CONSIDERATIONS?

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BACKGROUND NOTE

Assignment clauses are routinely used in almost every commercial and land agreement. The right to transfer a property right interest (an assignment) to another party is considered a valued and important legal and commercial privilege.

While assignment rights are rarely challenged, and somewhat taken for granted that the right is secure and legally enforceable, there are some pitfalls that the person drafting assignment clauses, such as the negotiator and practitioner, should be aware.

This white paper is structured to address the following issues associated with assignment rights:

- Discussion of an example of one material pitfall - *failure to adequately express the terms and conditions affecting an assignment* - associated with the right of assignment, is structured by way of a case study (while fictional parties are assumed, the commercial setting is real),
- History of assignments,
- Pitfalls to avoid, and
- Example assignment clauses.

DISCUSSION

Assignment

Assignment generally involves the transfer of property *rights*.

During early common law (then, primarily an agrarian or land based society), assignments were initially considered ineffectual or invalid. It was believed that the contractual relationship between parties was too personal to permit the interjection of a third person into the relationship without the consent of the non-assigning party (the obligor).

Early ways around assignment prohibition was to use a *power of attorney* appointing an agent (who is also de facto the 'assignee') to enforce the right and permitting him to retain the proceeds. (For example:

- Party A borrows money from Party B and agrees to timely pay it back.
- Party B owes a money debt to Party C.
- Party B gives Party C a power of attorney (as Party's B agent) to enforce the debt against Party A, and
- Party C can retain Party A's payments as an offset against the money Party B owes Party C).

In time,

- as society became more mobile and commercial (originally wealth was primarily land and secondarily chattels or non-land property which transitioned in modern times into more wealth being in intangibles such as bank accounts, securities, etc.) -

courts of law and courts of equity (those courts that rule on cases using a ‘what is fair and equitable’ test instead of just pure written law), approved assignments generally by allowing the assignee (the transferee or recipient of an assignment) to enforce the assignor’s rights and sue in the assignor’s name, however, the assignor also had to be a named party to the suit.

Over time, free alienability or transfer of one’s rights and interest in assets was seen as a commercial necessity. In time, statutes have been enacted permitting the assignee to sue in his own name without naming the assignor as a named party in the suit.¹

To say a party has a **right** means that he has the aid of organized society in controlling the conduct of that other person in some respect. An assignment is an expression of intention by the assignor that his **right** shall pass to another, the assignee. Assignments made for consideration (or exchange of value) are considered irrevocable, whereby the assignor permanently gives up the legal right to take back the assignment once it is made.

Generally, assignment of **rights** must be in writing.

An assignment generally requires three parties:

1. Party 1 (to the original deal) being the non-assigning party;
2. Party 2 (to the original deal) being the assigning party (assignor); and
3. Party 3 (not part of the original deal) being the recipient of the assignment transfer (assignee)

In any assignment there are two distinct aspects (and each could happen independent of the other):

1. Assignment of **rights** only (the benefits of the transfer)
2. Assignment (assumption or delegation) of performance **obligations** or commitments.

Rights

Rights are generally NOT assignable (or if assigned, unenforceable) **if**:

- I. Assignment would materially change the rights and duties of the non-assigning party;
- II. Where the assignment would vary materially the burden or risk of the non-assigning party (the obligor);
- III. The assignment would impair materially the non-assigning party’s chance of obtaining return performance from the assignee, especially in regard to an Executory bilateral contract... (i.e. Executory bilateral contract –on-going performance obligations between two parties in the future... If an assignee expressly promises his assignor to perform, the assignee is liable to the contracting (non-assigning) party on a third party beneficiary basis. There is a minority view that the assignee also impliedly promises to the assignor to be the delagatee of all of

¹ In the U.S. assignments are, in addition to contractual agreements, governed by the Uniform Commercial Code and Restatement , Contracts (2d).

assignor's duties [and such delegation is enforceable by the assignor against the assignee if the non-assigning party sues the assignor for non-performance]);

IV. Where there are certain intrinsic assignment right restrictions such as:

1. Option contracts;
2. Partnership rights;
3. Public policy limitations;
4. Contractual prohibition against assignability;
5. Voidable assignments (if gratuitous, infancy, insanity, fraud, duress);
6. Non-delegable due to personal unique nature of performance not performable by a third party (...the concert pianist case...).

Duties and Obligations

In contrast to **rights** being assigned (the beneficial interests of the assignment), the parties must also determine how any **duties** or **performance obligations** that may be associated with the interest or right assigned are to be assumed or delegated: Do such performance obligations or **duties** remain with the assignor or are they also transferred to the assignee along with the assigned rights? And if transferred to the assignee, who can enforce such **duties** or obligations (the assignor and/or the non-assigning party?).

Rights are assigned; Duties are delegated.

Assignment of performance obligations or commitments occur under common law if there has been an "assumption" by the assignee of such obligations and "delegation" of such obligations by the assignor to the assignee, ("Assumption" and "delegation" are terms of art used in common law and still used today by many jurisdictions and their statutes). In many jurisdictions, a "novation" agreement needs to accompany an assignment agreement and signed by all three parties (assignor, assignee and non-assigning party) which expressly confirms transfer of not only assigned rights but also assigned obligations (ay assumption and delegation) to the assignee and simultaneously relieving the assignor of such obligations (in effect termination of the original assignor duties and substitution of the new duties by the assignee)

A duty or performance obligation can never be escaped by assignment or **delegation** (absent the parties intent to the contrary) but any duty or performance obligation can be extinguished or fulfilled by performance.

Delegation involves the appointment of another to perform one's duties.

An assumption of duties occurs if the person who has been delegated to perform makes a promise to perform which is intended to benefit the person to whom the duty is owed.

When a duty is delegated, the delegating party (assignor) continues to remain liable (absent an agreement to the contrary) even though the delegating party (assignor) no longer has any interest in the right assigned. If this was not so, every solvent person could obtain freedom from his debts by delegating them to an insolvent. Delegation involves the appointment by the obligor (assignor) of another (assignee) to render performance on his (assignor's) behalf.

Novation

A party (assignor) making a delegation may be discharged, prior to performance associated with the assigned right, by a **novation**: a three party agreement whereby,

1. the delegate (assignee),
2. assumes the duty of the original obligor (assignor), and
3. this assumption is accepted by the obligee (the non-assigning party),
4. in substitution for the original obligor's (assignor) liability.

For a **novation** to be valid ...

1. all parties must assent to the novation (assignor, assignee and non-assigning party);
2. there must be a previously valid contract (between the assignor and non-assigning party),
3. the duties provided for in the contract be extinguished immediately (between the assignor and the non-assigning party) and
4. a new, enforceable contract need be created (between the non-assigning party and the assignee).

Novation is the innovation of the extinction of an obligation by creating a new one to replace or replace it and there must be an intention to novate (more than a mere transfer).

Covenants Running with the Land

Encumbrances or restrictions associated with land (that can affect subsequent parties such as assignees), either express or implied, generally fall within one of two 'covenant' (a promise to perform certain obligations or commitments) categories:

1. Personal covenants or 'easements in gross', which are personal and can only be performed by the original parties to the agreement; or
2. Covenants that run with the land, which must be complied with by original and future 'owners' of the land.

Covenants that run with the land are enforceable against assignees of the parties.

For **covenants that run with the land** to be enforceable, the following **criteria** are generally required:

- **The covenant must "touch and concern" the land.**
 - Restrictions or performance obligations are private agreements that apply to a 'permanent' asset, the land. Thus the restriction or performance obligation must be connected to the land.
- **There must be privity of estate.**
 - Privity involves a legal mutual obligation connection with the original parties to the deal and passage of that connection onto assignees. Enforcement of a right is derived from the intentions of the parties which is ascertained from the language of the underlying agreement, construed in connection with the circumstances existing at the time it was executed.
- **Reasonableness test**
 - Encumbrances generally must be reasonable under the circumstances otherwise they might be construed as unenforceable involuntary servitudes.
- **Notice**

- Typically, a third party acquiring a property interest is entitled to have notice of relevant encumbrances. (A bona fide purchaser for value without notice, sometimes can escape an encumbrance obligations if not on adequate notice).
- Typically international land transactions in the E&P industry do not lend themselves to Western country styled public land records in which relevant encumbrances can be posted and searched and by the nature of the record all parties impliedly put on at least constructive notice of possible encumbrances, avoiding claims of lack of notice of an encumbrance. Encumbrances are often a private nature and not created by the government (and if government derived is typically contained in the underlying recordable public record title documents). Consequently private encumbrance notice is more challenging but usually provided by:
 - The assignee (if an international experienced E&P entity –the savvy businessman test, is on at least constructive notice of general private encumbrance risks) inquiring or requiring title guarantees and warranties from the assignor that no encumbrances exist except for those disclosed (and if not disclosed, resulting in potential claims against the assignor).
 - Even so, if the assignor fails to disclose an encumbrance, the assignee might claim against the non-assigning party, bona fide purchaser for value without notice obligation exemption...
 - The assignor disclosing private encumbrances to potential assignees (since the assignor is on express notice of the encumbrance) and therefore has a duty to disclose. Failure to disclose by the assignor, could result in the assignor incurring liability claims from the assignee.

PITFALLS TO AVOID

Enforcement and Defenses for Assignment

The cases, legal writings and practice indicate in the absence of specific language, the assignment language is subject to interpretation and that interpretation is based on the intentions of the parties as determined by the “4 corners” of the document in which the assignment language is used. (Typically, the determination or not of a contract terms concerning assignment being ambiguous is a question of law, answered by a court, the judge, not the jury). The agreement alone will usually be deemed to express the intentions of the parties, for it is the objective contractual intent and not the subjective intent that controls. When an instrument is not ambiguous on its face, extrinsic evidence may not be used to create ambiguity.

Although the use of language such as “inclusion of assigns and successors” as parties to an underlying agreement is common practice, that language alone may not by itself be sufficient to indicate an assumption and delegation of performance obligations by an assignee and could, depending upon the intent of the parties and balance of terms and conditions in the underlying agreement, be limited to only assignment of rights and not assumption or delegation of duties or performance obligations.

The non-assigning party (as a third party beneficiary) can assert any defense against an assignee that it had against the assignor. Thus the assignee stands in the shoes of the assignor in regard to contract compliance and enjoyment of benefits.

(The non-assigning party may also advance a collateral claim or set-off against the assignee if the set-off action matured before the non-assigning party received notice of the assignment.²)

A non-assignment clause in an agreement bars delegation of duties (though assignment of ones rights can generally always be transferred).

Two practical assignment enforcement issues include:

1. Where an assignment involves the circumstance where the assignee is assigned a beneficial right by an assignor and the assignee is unaware of any associated obligations of the assignor (especially where the assignor provides a warranty that the assignment is free of any encumbrances, duties or obligations). Should the non-assigning party desire to enforce against the assignor and the assignee, any duties owed to it by the assignor, the assignor could be insolvent and the assignee could claim a good faith purchaser without notice, defense, thereby leaving the non-assigning party without a remedy.
2. Where an assignment involves a circumstance as in the scenario case example, where a collateral right is assigned and the assignee does not have privity of contract with the non-assigning party.

Mechanisms to optimize enforcement of assignment duties and obligations against the assignee include:

- Dealing with solvent parties who if they default in their assignment obligations will be able to financially cure a claim;
- Contractually agreeing to a lien on rights that might be inappropriately assigned;
- Agreeing to some form of publication (or notice) of assignment rights in order to establish a form of public notification forum, intended to prevent a third party assignee from claiming good faith purchase for value without notice. (Since in international forums, typical OECD public deed records, do not normally exist, finding an appropriate public notice forum may be difficult);
- Drafting assignment clauses to clearly describe relevant rights and delegation or assumption of duty responsibilities;
- Clarifying to what extent assignment restrictions apply to an agreement between the parties as well as collateral assignment rights (as in the example scenario case)
- In assignment documentation, use of defined terms such as “assumption” or “delegation” of duties and obligations as well as necessity to enter into a novation agreement.
- Specifically citing in the agreement express terms that an agreement, including any of the rights or obligations or duties associated with the agreement including any collateral assigned rights and/or duties, are non-assignable without a party’s prior written permission (which permission may not be unreasonably withheld).

² Normally a gratuitous or charitable (donative) assignment is revocable at any time except where an assignee has materially changed its position to its detriment in reliance on the gratuitous assignment. The defense of Estoppel is available to enforce the assignment in this case... The assignor is estopped (an equitable defense) from revoking the assignment because of the detrimental reliance.

EXAMPLE ASSIGNMENT CLAUSES

1.1 **Assignment**

This Agreement and the rights and obligations hereunder may not be transferred or assigned by either Party without the prior written consent of the non-assigning Party, and any attempt by a Party to transfer or assign this Agreement or any rights or obligations hereunder in violation of this Article 1.1 shall be null and void. In the event the non-assigning Party consents to a proposed assignment by the assigning Party of the assignor's rights and the assignee agrees to the assumption and delegation of any and all performance obligations and duties arising from the Agreement associated with such rights, such assignee must agree to be expressly bound hereby and the assigning Party shall remain liable for its obligations hereunder, and the parties shall enter into a novation agreement, confirming the assumption and delegation of duties and obligations.. ...*[Nothing contained in this Article 1.1 is intended or shall be construed to prohibit or otherwise restrict a Party's right, following the execution and delivery of the JOA, to Transfer (as defined in the JOA) all or part of such Party's Participating Interest in accordance with the provisions of the JOA. Editor's note...the italicized insertion is intended to be limited in scope to allow the primary assignment to take place but not any others.]*

1.1 **Successors and Assignees**

Subject to the limitations on Transfer contained in Article ??, this Agreement shall inure to the benefit of and be binding upon the successors and assignees of the Parties.

1.1 **Grant**

Subject to the satisfaction of the Conditions Precedent, and in exchange for the Consideration, Farmor shall assign and transfer to Farmee, and Farmee agrees to accept, a _____% Participating Interest in the Contract [*, JOA and other Documents*] and the Parties shall execute and deliver the Assignment.

1.1 **ASSIGNMENT OF THIS AGREEMENT**

The Receiving Party may assign this Agreement to an Affiliated Company; provided, however, the Receiving Party shall remain liable for all obligations under this Agreement. Receiving Party may assign this Agreement to a person or entity that is not an Affiliated Company only with the prior written approval of Disclosing Party. Any attempted assignment by Receiving Party to a person or entity that is not an Affiliated Company without the prior written approval of Disclosing Party shall be void. Without limiting the prior provisions of this Article 1.1, this Agreement shall bind and inure to the benefit of the Parties and their respective successors and permitted assigns.

EXAMPLE NOVATION FORMS

The following Novation Forms and examples are attached:

- Form of Novation Agreement A (for maritime activities)
- Form of Novation Agreement B (U.K. Law Society)
- Form of Novation Agreement C (Subcontractors)
- Form of Novation Agreement D (ISDA, International Securities Dealers Association)
- Form of Deed of Assignment

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