

ASSIGNMENT OF RIGHTS AND ITS PRACTICAL RELEVANCE IN FINANCIAL TRANSACTIONS: A LENDER'S PERSPECTIVE

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INTRODUCTION

'Assignment' means transfer of contractual rights or liability by a party to the contract to some other person who is not a party. It would not be wrong to say that as a matter of established principle, obligations are not assignable and once assigned it amounts to novation. For example, if *A* owes *B* INR. 500 and *B* owes *C* a like amount, *B* has the right to receive from *A* and is under liability to pay *C*. *B* can ask *A* to pay directly to *C* and if *A* accepts, that will be an assignment of *B*'s right to *C*. Considering the same situation if instead of transferring such a right *B* would have transferred any of his obligation in the matter, it would have amounted to novation. Section 37 of the Indian Contract Act, 1872 enables parties to dispense with performance by way of assignment. The debtor is not a party to the transaction and his consent is not required for its validity.

Assignments of receivables out of transactions are growing at an astronomical rate; in the world of finance the intricacies of such transactions are of immense importance. Notice should be taken of the fact that the concept of assignment is embedded both in the Indian Contract Act, 1872 and Transfer of Property Act, 1882, in form and content. It is a choice available to lenders to secure themselves against the adversities that may arise in the due course. A lender generally secures its transactions by way of mortgage & hypothecation over the immovable and movable properties of the borrower respectively. This is a well-known fact. In recent times the trend in certain high risk transactions has been to secure the loan by way of assigning contractual rights, along with the other securities such as mortgage and hypothecation, depending upon the nature of the transaction.

While the current level of commercial use of assignment has never been seen in the past, assignment of debts or contractual benefits has been there ever since the law of contract has existed, and has almost been the same over the ages. The word assignment is used in the context of incorporeal, that is, intangible assets. Corporeal assets are transferred; incorporeal assets are assigned, as the physical dimension of transfer, meaning change of hands, is not applicable in case of intangible assets.

But with regard to assignment of contractual rights or benefits, there lies intricate documentation. As per the existing laws in India, such transfer of contractual rights cannot occur without it being brought into writing. Section 130 of the Transfer of Property Act, 1882 implies that every actionable claim may be transferred and it points out as to how it may be transferred. The requirement of an instrument for such a transfer often makes it too expensive for the parties involved in the transaction. This paper seeks to deal with question of practical usage of assignment in general day to day financial transactions in content and form.

WHAT KIND OF CONTRACT IS ASSIGNABLE? : PRUDENCE OR PATIENCE?

The common law did give effect to three kinds of transactions, viz. *novation*, *acknowledgement* and *power of attorney*, which to some extent did the work of assignment.¹ As per the Indian contract law, any type of contract may be assigned as long as there is consent involved in the assignment. It needs to be looked at from the perspective of the parties. In such contracts, there are three parties involved, namely, the assignor, assignee and the obligor.

A contract entered into between two parties, relying on the personal skills of the '*promisor*', cannot be assigned under any circumstances. This is such because of the plain reason that the '*promisee*' had

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¹ Marshall, *The Assignment of Choses in Action*; Bailey, 47 L.Q.R. 526; 48 L.Q.R. 248, 547.

entered into the contract solely on the basis of the expertise which the '*promisor*' is possessed of. It is true in cases of contracts relating to like qualities or qualifications.

The judicial trend in India has reiterated this position time and again. It has laid down; rights under a contract are freely assignable unless: a) The contract is of a personal nature; b) The rights are incapable of assignment either under law or under an agreement between the parties. Hence, if the parties intend to restrict assignability, it is best to state the intent expressly in the contract. Likewise it should also be noted that it is prudent to expressly record a party's right to assign, if that is the intention. Any agreed limitation on such assignment should be expressly laid down in the contract in its boiler-plate sections, to avoid adverse consequences. Care and caution should be exercised while drafting a contract. The treatment may be different depending on the nature of the contract. For example, in agreements with private equity investors, it is common to see a right to freely assign rights and obligations in favour of its affiliates. A pre-consent of other parties to the agreement is obtained through such clauses, and all that is usually required to give the assignment effect is the execution of a deed of adherence between the assignor and the assignee. Thus it is deemed prudent to state the intent as to assignment in a contract in its boiler-plate sections to avoid any adverse legal consequences in the future.

MODES OF ASSIGNMENT: AVAILABLE RECOURSES?

It is both rights under a contract which may be assigned. Due note should be taken of the fact that obligations under a contract cannot be assigned unless without the consent of the counterparty to the contract. Neither in law nor in equity could the burden under a contract be shifted off the shoulders of the contractor on to those of another without the consent of the contractee.² The principle that the burden under a contract cannot be transferred so as to discharge the original contractor without the consent of the other party means that, as a general rule, the assignee of the benefit of a contract involving mutual rights and obligations does not acquire the assignor's contractual obligations.³ The introduction of the new party to an existing contract would itself amount to a novation of the existing contract, that is, the creation of a new contract between the original party and the new party. Courts have proceeded on the basis that a transfer of "obligations" can be effectuated only through a novation. Hence, the assignment clauses in contracts should also deal with novation, if the intention is to transfer obligations as well and such intention should be intimated to the party concerned. The intention of the parties is to be gathered from the nature of the agreement and the surrounding circumstances. Nevertheless, in law, there is a clear distinction between assignment of rights under a contract by a party who has performed his obligations there under, and assignment of a claim for compensation which one party has against the other for breach of contract. The latter is a mere claim for damages which cannot be assigned in law; the former is a benefit under an agreement, which is capable of assignment.

An important principle affecting assignments is that the burden of or liability under a contract cannot be assigned. The *promisor* has the right to insist that performance shall be the responsibility of the *promisee*.⁴ The *promisor* may have contracted with him by reason of the personal confidence which he reposed in him and, therefore, the *promisor*, can object to the contract being performed by any other person. This is more particularly true of cases in which the engagement is of personal nature, such as, the engagement to sing or to paint. In such cases there is no question of vicarious performance. In other cases it should not matter to the *promisor* whether the performance is offered by the *promisee* himself or by someone else acting for him, provided, of course, that the *promisee* is

² *Chitty on Contracts*, para 19-077, Sweet and Maxwell, 30th edn. 2008.

³ *Ibid*

⁴ *Robon & Sharpe v. Drummond*, (1831) 2 B & C Ad. 303.

responsible for the performance by his agent.⁵ A vicarious performance is not an assignment in the real sense of the word as the assignor remains liable for all the lack in performance which may arise in the due course of the business relationship.

Where with the consent of the promisor, the promisee drops out and some other person takes over his obligation, it is also not an assignment. It is a novation, that is, change of parties with mutual assent.

*“As a rule obligations under a contract cannot be assigned except with the consent of the promisee, and when such consent is given, it is really a novation resulting in a substitution of liabilities”.*⁶

The Supreme Court has observed that, as a rule, obligations under a contract cannot be assigned except with the consent of the *promisee*⁷. Where such consent is obtained, it will be considered as a deemed novation, resulting in the substitution of liabilities and obligations to the assignee. The introduction of a new party into an existing contract would itself amount to a novation of the existing contract, that is, the creation of a new contract between the original party and the new party, which makes it all the more necessary for assignment clauses in contracts to deal with novation; if the intention is to transfer obligations as well.

As per the Transfer of Property Act, 1882, assignment of contractual rights or benefits has been couched under the term ‘actionable claim’ and is dealt with extensively under Section 130 of the Act. Under the English law there is a distinction between an absolute transfer of a chose in action and a transfer by way of a charge. This section does not make such a distinction and the provisions hereof apply to both.⁸ A transfer of an actionable claim can be effectuated simply by execution of an instrument in writing. Nothing more is necessary. An assignment must conform strictly to the provisions of this section, and there must be words of transfer in the instrument.⁹ Where a letter written by an insurance agent did not show that he was transferring his interest in the commission and it was not addressed to the chief agent, the letter did not effectuate an assignment of the commission.¹⁰ Thus it may be noted that the intention to assign is of extreme importance but what cannot be taken out of consideration is the instrument to effectuate such an assignment.

Speaking from the lenders perspective and taking into consideration the stamp duty charges and other incidental costs as regards registration of the instrument of transfer; it stands as a formidable issue for the parties involved in a banking & finance transaction. It may be noted that the stamp duty charges in India are as such not linear. As it falls under the concurrent list, both the centre and the state have the power to legislate on the issue. This has given rise to different states having different rates of stamp duty which makes the incidental costs exorbitant in certain cases. While transferring a contractual right, one has to do so by way of a deed of assignment as provided under the property laws. To give effect to this instrument, it has to be mandatorily stamped. As discussed before, such stamp duty in India is extremely high and shoots over the roof in certain States. This stands as one of the challenges with assignment of rights and the instrument thereof.

⁵ *British Waggon Co. v. Lea & Co.*, (1880) 1 QBD 149. The party who actually performs has a right to ask the other party not to pay or to stop paying the main contractor till his dispute with the main contractor is resolved. *Yab Kee Seong v. Teguh Bina*, (1992) 1 Current LJ 525 High Court of Shah Alam.

⁶ *Ibid.*

⁷ *Khared and Co. Ltd. v. Ramon and Co. Pvt. Ltd.* (1963) 3 SCR 183; AIR 1962 SC 1810.

⁸ *Santuram v. Trust of India Assurance Co.* AIR 1945 Bom 11, 46 Bom LR 752.

⁹ *Balaram v. Gopinath* AIR 1954 Ori 44; *Alkash Ali v. Nath Bank Ltd.* AIR 1951 Assam 56.

¹⁰ *Ibid.*

ASSIGNMENT OF RIGHTS AND THE DEBATE THEREOF REGARDS EQUITABLE & LEGAL ASSIGNMENT: SPEAKING OF FORMS?

The common law refused to give effect to assignments of “choses in action”, that is, of rights which could be asserted only by bringing an action and not by taking possession of a physical thing. The common law also recognized that assignments were effective in equity: thus a promise by the assignee to not sue the debtor was good consideration for a promise by the debtor to pay the assignee.¹¹ And although an assignment did not at law entitle the assignee to sue the debtor, it might be binding as a contract between the assignor and assignee, for breach of which the assignee could recover damages.¹² Equity regarded the common law’s fear of maintenance as unrealistic and took the view that “choses in action” were property which ought to be transferred, in the interest of commercial convenience; that is to provide security for a loan.¹³ Here the difference is with regard to the nature of the ‘chose’. A legal chose is one which could be sued for only in common law court e.g. a contractual debt, whereas an equitable chose is the one which could be sued for only in the Courts of Chancery, e.g. an interest in a project..

Under the existing framework of law on assignment there exist two types of assignment: legal and equitable. A legal assignment would be that which conforms to the requirements specified under Section 130 of the Transfer of Property Act, 1882 as to formalities, intention to assign, communication to the assignee and notice to the debtor. When these requirements are not met the assignment takes the form of an equitable assignment. An equitable assignment also relates to a transfer of future benefit as it is not enforceable under the present laws but holds good only in equity. An agreement between a debtor and a creditor that the debt owing shall be paid out of a specific fund coming to the debtor, or an order given by a debtor to his creditor upon a person owing money or holding funds belonging to the giver of the order, directing such a person to pay such funds to the creditor, operates as an equitable assignment of that part of the debt or funds to which the agreement or order refers.¹⁴ So far as the Indian Courts are concerned regarding the creation of equitable charges in respect of property, which may come into being in future, the courts are bound to follow the strict requirements of the Indian statute, and under the provisions of the present Act such an equitable assignment or charge can only be created by a document in writing as provided under the section.¹⁵

Where a document does not amount to a transfer within the meaning of Section 130, it may apart from and independently of the section operate as an equitable assignment of the actionable claim.¹⁶ The Supreme Court has reiterated this stand in a number of other cases as well and has followed the judgments given in common law by the Courts of England.¹⁷

POSITION AS TO PART-ASSIGNMENT: CURRENT STAND?

¹¹ *Forth v. Stanton* (1681) Wms. Saund 210; cf *Mouldsdale v. Birchall* (1772) 2 W.B.L. 820; *Master v. Miller* (1791) 4 T.R. 320, 341 (for another explanation, see *Israel v. Douglas* (1789) 1 H.B.L. 239). For other instances of recognition of assignment at common law, see *Winch v. Keely* (1787) 1 T.R.619; *Legh v. Legh* (1799) 1 B & P. 447; *Carpenter v. Marnell* (1802) 3 B & P. 40; *Crowfoot v. Gurney* (1832) 9 Bing 372.

¹² *Gerard v. Lewis*, (1867) I.R. 2 C.P. 305.

¹³ *Alloway v. Phillips (Inspector of Taxes)* [1980] 1 W.L.R. 888 at 893.

¹⁴ *Official Liquidator, Travancore N.B.S. Co. v. Official Liquidator, Travancore N & Q Bank*, AIR 1940 Mad 258, 1939 MWN 1054; *P. Venkata Rao v. M. China Venkatapathy* AIR 1965 Andh Pra 510.

¹⁵ *B.N. Railway Employees' Urban Bank v. Seager*, AIR 1942 Pat 307.

¹⁶ *Bharat Nidhi v. Takhatmal* (1969) 1 SCR 595, AIR 1969 SC 313, (1969) 1 SCJ 367.

¹⁷ *Loknarayan Sethia v. State Bank*, AIR 1969 SC 73; *Watson v. Duke of Wellington*, (1830) 39 ER 231; *Burn v. Carvalho* (1939) 41 ER 265; *Jagabhai v. Rustamji* (1885) 9 Bom 311; *Prahlad v. Tikaitni*, AIR 1956 Pat 233.

In a Madras case it was held, following the English law, that the transfer of a debt must be of the whole debt, and that a transfer of a portion of a debt is not recognized.¹⁸ But in a subsequent case of the same court it has been ruled that although a transfer of a part of a debt was not recognized in English common law, the assignment of a part of a debt has always been held to be good in equity, and is deemed to pass property in that portion of the debt. In enforcing such claim it would be necessary to implead the owner of the other portion of the debt, but, apart from that, there is no objection in equity to the enforcement of a claim for part payment of a debt.¹⁹ It has been held that the TP Act does not recognize any distinction between the whole debt and part of a debt. Both may be transferred under the Act if they come under the category of 'actionable claim'; as an actionable claim is a property.

The problem lies with regard to the applicability of the Code of Civil Procedure, 1908 in this matter. Order 2 Rule 2, being a rule of procedure, does not affect the right of transfer. It does, however, bar the right of suit in certain cases and it may prevent the transferee of a part of a debt from enforcing his claim and thereby make the transfer nugatory, as under this provision a single cause of action cannot be allowed to be split up into several causes of action.²⁰ What if assignment is done after the lender (assignor) has already filed a case for the recovery of the loan? In this case the borrower has often brought in to his recourse the provisions of the Code of Civil Procedure, 1908, Order 2 Rule 2 to disqualify the subsequent assignee from his claim. To counter this menace the lenders have sought an alternative and often submit a substitution claim or notice with the court so that the aforesaid provisions cannot be attracted.

ASSIGNMENT FROM A LENDER'S PERSPECTIVE: UNDERSTANDING THE DIMENSIONS?

In an effort to make sense of the concept it is important to view it from the lender's scope. Assignment is used in many a different manner and it varies on a case to case basis. As it is a contractual concept, it may be used in various different forms depending on the nature of the transaction. As it is already mentioned earlier, almost, every kind of contract is assignable; but from a lender's point of view let us consider the case of a project finance and loan securitization.

Project finance is a long-term method of financing large infrastructure and industrial projects based on the projected cash flow of the finished project rather than the investors' own finances. Project finance structures usually involve a number of equity investors as well as a syndicate of banks who will provide loans to the project.

In India, most project financings have been carried out under the Government's private finance initiative (PFI) and are known as Public Private Partnerships (PPPs). PFI was introduced in the early 1990s and aimed to introduce private sector skills and finance into the provision of public sector services. PFI is structured so that the private sector obtains finance - usually from a bank - to design, build and operate a facility for the benefit of the public. In return, the public sector grants this private sector partner a long-term contract to run the facility - usually for 25-30 years. Once the facility has been built, the public sector pays the private sector a monthly fee over the life of the project which is used to service the bank loan which financed the project which is used to service the bank loan which financed the project.

In these situations often arises a complex web of contracts between the parties. The lender is often left at a risk of credit default. What needs to be understood is the method used in securing the lender. In India, the lender is often secured by the borrower by way of an assignment of the borrowers rights in the project company. This charge is over the interest that the borrower has over the project company and includes its assets and receivables. It may be noted that corporeal assets are transferred whereas as incorporeal assets are assigned, as the physical dimension of transfer is debatable. As physical assets may be transferred either for sale, or security, or exchange, or gift,

¹⁸ *Doraisami v. Doraisami*, 48 MLJ 432.

¹⁹ *Rajamier v. Subramaniam*, AIR 1928 Mad 1201 (1207).

²⁰ *Durgi Singh v. Kesho Lal*, 18 Pat 839, AIR 1940 Pat 170.

likewise, assignment of incorporeal assets may be done either for sale, or exchange, or gift, or pledge or creation of security interest. If it is a sale, gift or exchange, the assignment will be absolute; if it is merely by way of a security interest, it may be conditional or specific. In most project finance cases, the borrower assigns his rights in the project company to the lender by way of executing a registered mortgage in the rights arising out of the project. In many cases one would find that development rights in the project company are assigned. It is found to be complicated but it is a very commonly followed practice in the world of finance.

What has to be taken into consideration in such cases is the fact that the borrower assigns its rights in the project company to consolidate the lender's risk. Such assignment is of contractual rights or benefits due to arise in the future. This is not the same as assigning obligations. The question is what is the legal status of such an assignment? Is it a legal assignment or an equitable one? Again, it has to be kept in mind that such an assignment is done by way of proper documentation as is provided under the TP Act, 1882. As the assignment is brought down into proper instruments it no longer retains the character of an equitable assignment. Although it works in equity as the rights which are assigned remains uncertain but the form in which it takes place is couched in as a legal or statutory assignment. So the question as to the form of assignment is solved and it is safe to note that it is a legal assignment conforming to the provisions of the TP Act, 1882. It is advisable that the lenders follow statutory assignments in such transactions.

There lies a pitfall in such transactions. It is of the astronomical stamp duty that the parties have to bear. It may be noted that to exclude the cost the lenders prefer not to execute a separate deed of assignment but to join it together with the deed of registered mortgage it executes over the immovable properties of the borrower. It is done mostly by way of an indenture created over the registered mortgage. Sometimes it is also done along with the deed of hypothecation created over the movable properties of the borrower such as its warehouses etc. In certain cases the lenders prefer a blank deed of assignment as the assignee is yet not known to the existing parties. The lenders save a good amount of capital in this process and it is considered to be a commonly followed practice in the world of finance.

The usage of assignment is frequently found in another form of transaction relating to securitization of loan portfolios. The form in which it is used stands on a completely different footing from what was discussed as in the case of project finance. Can loans owed to a lender be assigned by the lender to another person 'assignee'? Answering in the affirmative, it may be said that such an assignment is valid under the present laws of the land. It has to be noted that in such matters the assignor assigns his right in the loan amount owed to it by the borrower and this in no manner affects the arrangement between the parties to the contract as the borrower's position remains unchanged and it does not result into a novation. It may also be noted that it is not 'debt' but the right in the 'debt' which is assigned as debt as such is not assignable under the laws of contract without having the original contract altered. The assignee basically carries out the work of the assignor and it may be noted that with this assignment the assignor does not pass on to the assignee any right more than what he enjoyed under the previous arrangement. This works as a legal assignment and the right so assigned is an existing right.

In a recent case the apex court held that NPA's (Non-Performing Assets) may be assigned by one bank to the other without the concurrence of the borrower and it would not result into a novation as was claimed by the opposing party. The case also dealt with the question of validity of transfer of debt between banks and raised the point of its validity when read in accordance with the Banking Regulation Act, 1949.²¹

CONCLUSION

Assignment of contractual rights or benefits arising out of a contract is a very important tool available with the lenders to secure its rights against the borrower. It may be noted that in banking finance transactions the exposure of the lenders stand at a very high risk level. In view of this it is important to

²¹ *ICICI Bank Ltd. v. Official Liquidator of APS Star Industries Ltd. & Ors.*, Civil Appeal No. 8393 of 2010 (Arising out of S.L.P. (C) No. 2240 of 2009)

note certain significant commercial risks which may be associated with such transactions. Different transactions will have different requirements. Certain transactions would require the borrower to assign its rights as has been noticed in case of a project finance matter. The question of stamp duty incidence with regard to such transactions should be addressed with much concern. The Parliament should consider framing a linear set of laws as regards stamp duty with a view to make business a little easier in India. In lending transactions, a borrower will expressly be prohibited from assigning rights or novating the contract, whereas the lender will retain an absolute and free right of assignment. Such a right enables the lender to sell loan portfolios to other lenders/parties or to a securitization company.

Factoring transactions and assignment of receivables also depend significantly on the assignment clauses of the relevant agreements in relation to which the receivables are being assigned. Assignment clauses under various agreements determine the contract's treatment in a transaction that involves the sale of a business or undertaking, together with such contracts.

The question of assignment comes under the stage of drafting an agreement. In this regard it is imperative to note that care and caution should be taken while drafting the assignment clause in the agreement. The apex court has time and again reiterated that the best policy in such matters is to unequivocally state the intent as to assignment in the agreement to avoid intermeddling of litigation in the future. It requires special consideration on a case-by-case basis, depending upon the nature of the contract and the specific requirements of the transaction. It is prudent to expressly set out the intention as to assignment in the agreement whether the intent is to allow or restrict or limit assignment, the advice is usually to write it expressly.
