ASSIGNMENTS: WHY YOU NEED TO SERVE A NOTICE OF ASSIGNMENT

23 June 2017

It's the day of completion; security is taken, assignments are completed and funds move. Everyone breathes a sigh of relief. At this point, no-one wants to create unnecessary paperwork - not even the lawyers! Notices of assignment are, in some circumstances, optional. However, in other transactions they could be crucial to a lender's enforcement strategy. In the article below, we have given you the facts you need to consider when deciding whether or not you need to serve notice of assignment.

What issues are there with serving notice of assignment?

Assignments are useful tools for adding flexibility to banking transactions. They enable the transfer of one party's rights under a contract to a new party (for example, the right to receive an income stream or a debt) and allow security to be taken over intangible assets which might be unsuitable targets for a fixed charge. A lender's security net will often include assignments over contracts (such as insurance or material contracts), intellectual property rights, investments or receivables.

An assignment can be a legal assignment or an equitable assignment. If a legal assignment is required, the assignment must comply with a set of formalities set out in s136 of the Law of
Property Act 1925, which include the requirement to give notice to the contract counterparty.

The main difference between legal and equitable assignments (other than the formalities required to create them) is that with a legal assignment, the assignee can usually bring an action against the contract counterparty in its own name following assignment. However, with an equitable assignment, the assignee will usually be required to join in proceedings with the assignor (unless the assignee has been granted specific powers to circumvent that). That may be problematic if the assignor is no longer available or interested in participating.

Why should we serve a notice of assignment?

The legal status of the assignment may affect the credit scoring that can be given to a particular class of assets. It may also affect a lender's ability to effect part of its exit strategy if that strategy requires the lender to be able to deal directly with the contract counterparty.

The case of General Nutrition Investment Company (GNIC) v Holland and Barrett International Ltd and another (H&B) provides an example of an equitable assignee being unable to deal directly with a contract counterparty as a result of a failure to provide a notice of assignment.

The case concerned the assignment of a trade mark licence to GNIC. The other party to the licence agreement was H&B. H&B had not received notice of the assignment. GNIC tried to terminate the licence agreement for breach by serving a notice of termination. H&B disputed the termination. By this point in time the original licensor had been dissolved and so was unable to assist.

At a hearing of preliminary issues, the High Court held that the notices of termination served by GNIC, as an equitable assignee, were invalid, because no notice of the assignment had been given to the licensee. Although only a High Court decision, this follows a Court of Appeal decision in the Warner Bros Records Inc v Rollgreen Ltd case, which was decided in the context of the attempt to exercise an option.

In both cases, an equitable assignee attempted to exercise a contractual right that would change the contractual relationship between the parties (i.e. by terminating the contractual relationship or exercising an option to extend the term of a licence). The judge in GNIC felt that "in each case, the counterparty (the recipient of the relevant notice) is entitled to see that the potential change in his contractual position is brought about by a person who is entitled, and whom he can see to be entitled, to bring about that change".

In a security context, this could hamper the ability of a lender to maximise the value of the
secured assets but yet is a constraint that, in most transactions, could be easily avoided.

Why not serve notice?

Sometimes it's just not necessary or desirable. For example:

- If security is being taken over a large number of low value receivables or contracts, the time and cost involved in giving notice may be disproportionate to the additional value gained by obtaining a legal rather than an equitable assignment.
- If enforcement action were required, the equitable assignee typically has the option to join in the assignor to any proceedings (if it could not be waived by the court) and provision could be made in the assignment deed for the assignor to assist in such situations. Powers of attorney are also typically granted so that a lender can bring an action in the assignor's name.
- Enforcement is often not considered to be a significant issue given that the vast majority of assignees will never need to bring claims against the contract counterparty.

Care should however, be taken in all circumstances where the underlying contract contains a ban on assignment, as the contract counterparty would not have to recognise an assignment that is made in contravention of that ban. Furthermore, that contravention in itself may trigger termination and/or other rights in the assigned contract, that could affect the value of any underlying security.

What about acknowledgements of notices?

A simple acknowledgement of service of notice is simply evidence of the notice having been received. However, these documents often contain commitments or assurances by the contract counterparty which increase their value to the assignee.

Best practice for serving notice of assignment

Each transaction is different and the weighting given to each element of the security package will depend upon the nature of the debt and the borrower's business. The service of a notice of assignment may be a necessity or an optional extra. In each case, the question of whether to serve notice is best considered with your advisers at the start of a transaction to allow time for the lender's priorities to be highlighted to the borrowers and captured within the documents.

For further advice on serving notice of assignment please contact Kirsty Barnes or Catherine Phillips from our Banking & Finance team.
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