



Why Assign Debt?

Understanding an often forgotten clause in a banking contract

How many times have you signed a contract or a standard form agreement with a bank or financial institution with an "Assignment Clause" in it? Have you ever paused to ponder what this clause means, or the obligation it imposes on both parties? What rights arise from it? What obligations are imposed by this clause?

An assignment encompasses the transfer of rights held by one party- the assignor-to another party- the assignee. For example, if party A contracts with party B to lend him under a loan agreement, \$100,000, plus interest, party A can later assign the benefits of this agreement, that is, the right to be repaid the \$100,000 plus interest to party C. In this scenario, party A is the assignor, party B is a debtor and party C is the assignee. The effect of a valid assignment is to extinguish the contractual arrangement between A and B and introduce the C as the recipient of the benefit of the contract.

Why assign?

It is a usual occurrence in the financial world. An assignment usually occurs where a debtor defaults on a debt (for example, a loan or a credit card). The bank or financial institution will generally try and collect the outstanding debt on its own. After a while this becomes too expensive or time consuming and the debt is written off by the bank. Believe it or not, when the bank assigns the debt, this is at a general benefit to its customers. As a practical matter, the high costs of trying to collect the defaulting debts, is a huge expense which would necessarily be passed on to its customers, possibly in the form of higher interest rates.

The bank will therefore, generally bundle all the defaulted debts and transfer the debts by way of assignment to an institutional debt collector for a much smaller sum than the original debt due. The debt collector is now in the shoes of the original creditor, the bank, and is now entitled in law to receive the full amount owing on the defaulted debt from the original borrower.

A right to recover a debt is a perfect example of a legal right capable of assignment. A debt, strictly speaking, is a right to demand payment of money at a stipulated time arising out of a legal obligation such as a contract. That stipulated time may be a future specific date, or the debt may be payable on demand or on the occurrence of some defined future event. Only, property (as legally defined) is capable of being transferred and the law recognizes a debt as the property of the person to whom it is owed- it is a chose in action.

A chose in action is the rather technical and legal term used to describe what are known as intangible (as opposed to tangible) property. These forms intangible property although not capable of physical possession are considered in law to be property capable of being transferred.

Other choses in action (or intangible property) include rights under a contract, leases, rights or causes of action; stocks and shares. Intellectual property and equitable rights. An example of a tangible property would be for example, a car or a house.

Every contract will contain both benefits and burdens. Only the benefit is assignable, that is, to use our example, only the right to receive the repayment with interest. The party obliged cannot- at least

by way of assignment- cause his burden to be transferred. This may be done by another process known as novation.

What is the effect of an assignment?

Once an assignment is not prohibited by the contract, the party receiving the benefit of the contract can assign his benefits to a third party. What this means to the other original contracting party, or in our example above, B, is that, it causes B's duty to perform the loan agreement to shift from the A to C.

Consequently, if B defaults on the loan or if there is any failure to perform, C can bring a claim for the debt, as he now holds the exclusive right to commence an action in the Courts or do all other things legally allowed to recover the debt (this includes where there is a mortgage over any property used to secure the loan, exercising the power of sale pursuant to the Registration of Titles Act).

Also, at this stage, because the assignee "stands in the shoes" of the assignor, the debtor can also raise any defence to the contract that he could have raised against the original contracting party (A). Furthermore, the borrower can raise against the assignee counterclaims and set-offs that the obligor had against the assignor.

Notice to the debtor

Generally speaking, an assignor will, as a matter of prudence, notify the debtor of the assignment even though notice to the debtor is not required. The obvious benefits of giving the debtor notice of the assignment include:-

Until the debtor is given notice of the assignment, he is entitled to treat the assignor as being his creditor, so that payment to the assignor will still discharge the debtor's liability;

Until the debtor is given notice of the assignment, the assignees rights against the debtor are at risk of being defeated by a subsequent assignment by the assignor, if it is notified to the debtor before the earlier assignment.

An assignment does not absolve the debtor from its obligations to repay the loan, nor does it increase its obligations. It is however, important to fully understand the effects it will have on the next contract you sign.

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