SECTION 11 CONTRACTUAL REMEDIES ACT 1979 - UNINTENDED CONSEQUENCES?

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Introduction


However, while the effect of sections 4 to 10 of the Act are well known and have been well canvassed by the Courts, section 11, an often ignored section, appears to alter the law of assignment in significant ways.

Section 11(1) of the Act says:

Subject to this section, if a contract, or the benefit or burden of a contract, is assigned, the remedies of damages and cancellation shall, except to the extent that it is otherwise provided in the assigned contract, be enforceable by or against the assignee.

The effect of the section, as recently affirmed by the Court of Appeal in SB Properties Ltd (in liquidation) v Holdgate, is to allow for the burden of a contract to be assigned and for the other contracting party to have an independent cause of action against the assignee of a contract. That appears to be inconsistent with the usually accepted position at law, which is that a burden of a contract cannot be assigned except when a novation occurs.

However, the reality is that the legal position is more complicated than the maxim “a burden of a contract cannot be assigned” allows for at first glance. This article, therefore, argues two propositions. First, that the burden of a contract can be assigned without a novation to ensure that the assignee cannot be in a better position as against the non-assignee party than the assignor. The second proposition is that the Court of Appeal in SB Properties Ltd was correct and section 11(1) allows for the other contracting party to take action directly against an assignee in a situation where an assignor defaults on his or her obligations and is insolvent, liquidated or has ‘disappeared’. This is because an assignee cannot be in a better position than an assignor, and therefore the risk of a ‘disappearing’ assignor should, and does, lie with the assignee rather than with another contracting party.

Assigning the burden of a contract

Assignment of the burden

Can the burden of a contract ever be assigned? The position at common law has long been that it cannot. The position was strongly expressed by Lord Collins MR in the case of Tolhurst v Associated Portland Cement Manufacturers (1900) Ltd 2, where he said at 668:

It is, I think, quite clear that neither at law nor in equity could the burden of a contract be shifted off the shoulders of a contractor on to those of another without the consent
of the contractee. A debtor cannot relieve himself of his liability to his creditor by assigning the burden of the obligation to somebody else; this can only be brought about by the consent of all three; and involves the release of the original debtor.

That dicta is often cited as establishing the principle that an assignment of contractual liabilities can only occur when there is a novation – in other words, where the other party to the contract consents to the assignee stepping into the shoes, and assuming the liabilities of, the assignor. The up-shot of this position is that a contract cannot ever be assigned in its entirety, at least, not without a novation in which case a new contract is formed.

However, the position is not as simple as Lord Collins MR’s comments would suggest. For example, merely because the assignor cannot relieve him or herself of the burden by way of an assignment, without a novation, does not mean that one party cannot vicariously perform the contractual obligations of another, provided that the assignor remains liable as well. Generally speaking, so long as there is no element of personal service required or some element of the contractual relationship which prevents it, the other contracting party cannot object if the assignor’s obligations are performed by the assignee, provided that the assignee does all that the assignor has agreed to do.

In addition, as the authors of Garrow & Fenton’s Law of Personal Property in New Zealand state at page 706:

_The rule that original contracting parties cannot transfer their obligations to third parties without the consent of the party they have contracted with should not be confused with the quite different question of whether the obligations under an assigned contract can be enforced against assignees who have enjoyed the benefit._

The law has often recognised that contractual burdens can be assigned and, indeed, equity has often demanded it. That normally occurs in circumstances where the benefit of a contract has been assigned and it has developed to the point where it can safely be said that there are two areas where the Courts have recognised that burdens pass with the benefit of a contract when an assignment of the latter takes place. That is where:

1. The assignee takes assignment subject to equities; or
2. The benefit of a contract is inseparable from the burden.

_Taking subject to equities_

The basic principle of law is that an assignee accepts the assignment of a chose in action subject to all equities between the assignor and the person liable on the chose which exist when the assignment occurs. Sections 130(1) of the Property Law Act 1952 and 50(3)(b) of the Property Law Act 2007 recognise this. It is a principle which has long been recognised in law 6.

The underlying principle is that the assignee cannot be better off than the assignor and so must take the chose assigned with any restrictions attaching to it. This was recognised in Bay of Plenty Electricity Ltd v Natural Gas Corporation Energy Ltd. In that case, Thomas J held that the assignee was bound by an estoppel against the assignor, citing English authority with approval that had said:

_the assignee of a chose in action, where there has been no fraud, stands in exactly the same situation as the assignor in respect of equities arising upon it._

The position at equity is that an assignee ‘steps into the shoes’ of the assignor, and the assignee cannot, in good conscience, end up in a position different from that of the assignor. This question normally arises in the context of assignments of debt, and an illustration of how it works in practice is provided by New Zealand case law.
The principle was considered and applied by Hammond J in the context of commercial factoring in Commercial Factors Ltd v Maxwell Printing Ltd. That case involved the factoring of a debt where there was an arrangement between the two contracting parties, who did business with each other, that there would be a swapping of cheques representing amounts due on 90 day terms on the 20th day of each month. The Defendant here refused to pay an amount of $53,733.40 because it was owed $103,017.12 pursuant to the arrangement already outlined. Hammond J considered that the arrangement gave rise to a valid set-off, a set-off being an equity “for the purpose of the rule that an assignee takes subject to equities”.

If the assignee takes subject to equities existing between the assignor and the other contracting party, precisely which equities is the assignment subject to? The answer seems to be that the assignment is subject to equities which relate to the chose in action, and which exist at the time of the assignment. The leading case on this question is Business Computers Ltd v Anglo-African Leasing Ltd. In that case a claim was made by the assignee of a debt for £10,587.4350. The defendant’s claimed a set-off of £1,477.4320 and made a counter-claim for £30,000.00 made under a separate agreement which pre-dated the assignment in question. Templeman J held at page 748 that a:

“debt which accrues due before notice of an assignment is received, whether or not it is payable before that date, or a debt which arises out of the same contract as that which gives rise to the assigned debt, or is closely connected with that contract, may be set off against the assignee. But a debt which is neither accrued nor connected may not be set off even though it arises from a contract made before the assignment.”

It is clear that the statement that ‘you cannot assign the burden of a contract’ is not strictly correct – if a chose in action is assigned, it is taken subject to equities existing at the date of the assignment. That is an important exception, and suggests a principled approach which might be taken to the question of assignment of a burden. Ultimately, equity has decided that an assignee cannot be in any better position than an assignor – and if that involves subjecting the assignee of the benefit of a contract to an equity, then so be it.

Benefit inseparable from the burden

Although an ‘equity’ is ill-defined and can extend to a contractual obligation, it is more typically seen as a set-off, counter-claim, withholding or right to a deduction. But having an assignment subject to equities is only part of a broader principle, which is also manifested in the concept that where the benefit of a contract is inseparable from the burden, then the two are assigned together.

Indeed, in some cases it is inappropriate to talk about a clear distinction between the “benefit” and “burden” of a contract, especially in the case of a bilateral contract where the rights are mutually dependent. Such cases merely serve to reinforce why the burden of a contract should be allowed to pass, together with the benefit, to give the other contracting party a right of action against the assignee.

In the lengthy decision of Megarry V.-C. in Tito v Waddell (No 2), His Honour outlined various approaches to this question including what has been called the “pure benefit and burden principle”. Indeed, the “pure benefit and burden principle” has come in for criticism, most notably from the High Court of Australia. What is not been argued for here is the recognition of a “pure benefit and burden principle”. Instead, what is been argued for is a recognition that the burden of a contract passes in a situation where the benefits under the contract are “conditional”.

At page 281 of Tito v Waddell Megarry V.-C. discussed the issue in some detail, and phrased the issue thus:
One of the most important distinctions is between what for brevity may be called conditional benefits, on the one hand, and on the other hand independent obligations. An instrument may be framed so that it confers only a conditional or qualified right, the condition or qualification being that certain restrictions shall be observed or certain burdens assumed, such as an obligation to make certain payments. Such restrictions or qualifications are an intrinsic part of the right; you take the right as it stands, and you cannot pick out the good and reject the bad. In such cases it is not only the original grantee who is bound by the burden; his successors in title are unable to take the right without also assuming the burden. The benefit and the burden have been annexed to each other ab initio, and so the benefit is only a conditional benefit.

The argument is that if the benefit of a contract is inseparable from the burden of it, then the two pass together and the rule that a burden cannot be assigned does not apply in such a case. That must be right, as while the assignor remains liable to the other contracting party, all that has happened is the assignee has become liable to the original contracting party as well.

An example of this might be where A grants B the right to grow crops on A’s land in return for payment. If B assigns the right to grow the crops to C it would be inequitable to say that C is under no obligation to pay A. Although B remains liable, and so there is no offence against the statement of Lord Collins above, C should also be liable.

However, although there have not been many cases on the point, the principle can also apply to situations that do not involve land (in relation to land, issues as to covenants may arise, but they are not dealt with here). Another example would be in a situation where it is agreed that A would pay B $100.00, but with the $100.00 being refundable on the occurrence of an event.

The $100.00 is due and owing as that date of the contract, it is just a ‘contingent’ payment, subject to the right to refund. If B assigns the right to the $100.00 to C, it would be inequitable to say that C can take that right, but not subject to the right of refund, especially if C is aware of that right. Of course, the issue only becomes acute in a situation where A has paid C, the right to the refund is triggered on the happening of the event, but B is insolvent and unable to pay.

In such a case, the law should place the risk on C of an insolvent or absconding B. C took the benefit of the $100.00, and it is inequitable to allow C to take the benefit without taking the burden – to do so is to effectively remove the benefit of the contract from A, namely the right to the refund. That is especially the case given that A has no rights as between B and C, and may have no right to prevent the assignment.

Of course, there are issues relating to the question of whether or not the assignment was voluntary, as neither the Property Law Act 2007 nor its predecessor requires the consent of C to the assignment. However, the issue only arises in a situation where C is attempting to enforce, or has enforced, its right and therefore is trying to receive, or has already received, the benefit. In such a case, C’s conscience is affected, even if C is unaware of the existence of the burden. The existence of a burden should be regarded as a risk that C takes, and the risk of an insolvent B should not be visited on A because C fails to make proper enquiries.

There is a valid argument that A has a right to make it a condition of the contract that B cannot assign the benefit of the contract. It is really a question of where the ‘risk’ of an absconding B should lie. In the author’s view it makes better commercial sense for the risk to lie on B, as in the majority of situations contracting parties will not turn their minds to the question, and given that it is C that is to receive the benefit it is better that the ‘risk’ should lie with C, who should make enquiries about the contract/benefit to be assigned.
This idea of the benefit being inseparable from the burden is supported by the case law which clearly establishes that the obligations under a contract need to be fulfilled before an assignee can attempt to enforce. This is clearly seen in the Court of Appeal case Field v Fitton 15. That case involved an agreement for sale and purchase of real estate which was assigned, and it involved considerations of whether the burdens placed on the purchaser by the agreement for sale and purchase where assigned as well as the rights under it. It was held by Bisson J for the Court at page 492 that “the assignees must also accept the burdens of the contract along with its benefits”. In that case, the practical outcome was that the contract could not be enforced unless the obligations of the assignor under the contract were met, and the case is taken as authority for that proposition.

As a result, so long as the benefit and the burden are sufficiently related, the burden passes with the benefit. That is consistent with the principle that a chose in action is taken subject to equities, and it is simply another facet of the over-arching principle that an assignee cannot be in a better position than an assignor.

Section 11 Contractual Remedies Act 1979

This principle – that an assignee cannot be in a better than position than an assignor – has now been codified in statute, and particularly in section 11 of the Contractual Remedies Act. Sections 11(1) and (2) say:

(1) Subject to this section, if a contract, or the benefit or burden of a contract, is assigned, the remedies of damages and cancellation shall, except to the extent that it is otherwise provided in the assigned contract, be enforceable by or against the assignee.

(2) Except to the extent that it is otherwise agreed by the assignee or provided in the assigned contract, the assignee shall not be liable in damages, whether by way of set-off, counterclaim, or otherwise, in a sum exceeding the value of the performance of the assigned contract to which he is entitled by virtue of the assignment.

Section 11(3) sets out the entitlement of the assignee to an indemnity from the assignor, while sections 11(4) and 11(5) deal with the section being subject to provisions of the Property Law Act 2007, the Consumer Guarantees Act 1993 and not affecting the law relating to negotiable instruments.

Section 11(1)

The first question that needs to be answered is what does section 11(1) – the key section - mean? The answer is that it means what it says: it allows the non-assigning party to a contract to enforce the remedies of damages and cancellation against the assignee of the contract, or the benefit or burden of the contract. Subject to the limitation in section 11(2), it allows the other contracting party a direct cause of action against an assignee of the benefit of a contract, and it effectively allows for the burden of a contract to be assigned on its own (although the assignor is still bound).

Such an interpretation is consistent with the apparent intention of the Contracts and Commercial Law Reform Committee in its Report (Misrepresentation and Breach of Contract), 1967 which, in commenting on the section said:

The problem therefore seems to us to amount to this: who, as between obligor and assignee should bear the risk of insolvency or disappearance of the misrepresenting assignor? We believe the assignee should do this. However, we could not expose an assignee to claims for damages of unlimited amount in a situation of which he may have been unaware. In the ordinary case, the assignee is not a guarantor of the assignor's obligations. In protecting the obligor's rights to set up as against an
assignee the real bargain made with the assignor, we must not enlarge those rights by providing the obligor with another prospective defendant merely by reason of the assignment. Hence we suggest a limitation upon the assignee's liability. The liability of the assignor to the obligor would remain unaffected.

That position is, as we have seen, consistent with the position at common law, and it continues the principle that an assignee cannot be in a better position than an assignor, and as a result it is the assignee who bears the risk of an assignor who cannot meet his or her obligations under the assigned contract.

Until recently section 11 of the Contractual Remedies Act had not received much judicial attention – which raises the question of how large the problem identified by the Contracts and Commercial Law Reform Committee was – but, when the courts have looked at the issue, the response has not been consistent, until the recent Court of Appeal decision in SB Properties Ltd.

Turning to the earlier decisions, perhaps the most widely cited is Gibbston Valley Estate Ltd v Owen 16. A Court of Appeal bench of Henry, Blanchard and Tipping JJ considered the section in the context of an assignment of an agreement for sale and purchase of real estate. The real question before the Court was whether or not the vendor under that agreement had to serve a settlement notice on the assignee (none had been served). The argument advanced by the appellant was that because the effect of section 11(1) was to give the respondent a remedy in damages against the assignee there arose a corresponding obligation to give a settlement notice to the assignee.

Blanchard J delivered the judgment of the Court, with Tipping J delivering a concurring judgment. The Court found that there was no obligation to serve a settlement notice in this case for two reasons. The first was that there was no absolute assignment in law, only a conditional assignment by way of a charge, and so section 11(1) of the Contractual Remedies Act 1979 was of no application.

The second reason is occasionally cited as meaning that section 11(1) did not change the position at common law in relation to the assignment of burdens. In his judgment Blanchard J said on section 11(1):

> It appears to provide there where the benefit of a contract is assigned, the other party to the contract (here the vendor) has a remedy in damages against the assignee if there is a breach of the assignor’s obligations under the contract…However, even assuming that interpretation is correct and that the assignment to Mr Reinke had come within s130, it seems to us that the combination of the two sections does not alter the obligations of the parties to the contract. Nor does it have the effect of making the assignee a party to the contract. That can occur only through novation.

Courtney J in Holdgate v Bloccassa 17, the decision appealed in SB Properties Ltd, considered that passage supported the view that section 11(1) has not altered the rule that, in the absence of novation, the assignee does not become liable for the burden of a contract. Support was also drawn from a comment by Tipping J to the effect that section 11(1) cannot result in an alteration of contractual duties.

With respect, however, the comments by Blanchard and Tipping JJ in Gibbston Valley Estate are referring to the specific facts of the case. What is being said is that if section 11(1) allows the other contracting party to enforce against the assignee then, in this case, the obligations of the other contracting party regarding the settlement notice do not change. In other words, the action available against the assignee under section 11(1) does not mean they are entitled to a settlement notice as that would be altering the other contracting parties’ obligations under the assigned agreement for sale and purchase.
In fact, the judgment of Blanchard J, although not expressing a concluded view, does outline what the effect of the section, if taken on its words, appears to be. Tipping J goes somewhat further in setting out, following the approach of Blanchard J, the ‘compass’ of section 11(1). He notes that there are three situations allowed for, being the assignment of a contract, the assignment of the benefit of a contract, and the assignment of the burden of a contract. His Honour then goes on to say:

In each case the section provides that the remedies of damages and cancellation shall, unless otherwise provided, be enforceable by or against the assignee.

In relation to the assignment of the benefit, Tipping J says:

When the benefit is assigned, the assignee cannot claim that benefit from the other contracting party without undertaking the burden. While the benefit may have been assigned as between assignor and assignee, that does not mean the assignee can divorce the benefit from the burden when seeking performance from the other party.

The obiter approach of the Court of Appeal in Gibbston Valley Estate Ltd to section 11(1) is the correct one. It gives effect to the plain meaning of the section, and it is also consistent with the ‘conditional’ benefit approach of Megarry V.-C. outlined earlier, as well as being consistent with the principle behind taking an assignment subject to equities. Further, it does not undermine the principle that a burden of a contract can only be assigned by novation, as it does not relieve the assignor of the burden. As Tipping J notes “the other contracting party, in the absence of a novation which discharges the assignor from the burden, may continue to look to the assignor to discharge the burden.”

This approach to section 11(1), which allowed for the assignee to become liable as well, was affirmed by the Court of Appeal in SB Properties Ltd in a unanimous judgment given by Baragwanath J. That decision was an appeal from the decision of Courtney J in Holdgate.

The Court considered the effect of section 11 in detail and agreed, at paragraph 18, that an assignor cannot shift the burden of a contract to an assignee without a novation. However, at paragraph 19 the Court said:

This case, however, is concerned with a different point: whether s11(1) adds to a continuing liability on the assignor a new liability on the assignee to the non-assigning party (albeit within the limits of subs(2)). While the common law held to the contrary (see Rhone v Stephens [1994] 2 AC 310 (HL)), we are satisfied that the answer is yes.

The Court concluded that Parliament had changed the law, and the common law must given way to the words of the statute (although, as has been argued here, the change to the common law is not as radical as most would think). At paragraph 25 the Court specifically endorsed the approach of Tipping J in Gibbston Valley Estate Ltd, including the proposition that a burden of a contract alone could be assigned.

Such an approach has also been adopted in other cases. In two decisions Randerson J has held that section 11(1) allows the other contracting party an independent cause of action against the assignee.

Also significant is the decision in Gray v UDC Finance Ltd 19. Wild J was reviewing a decision by Master Venning, as he then was. The case involved the plaintiffs entering into agreements to purchase apartments from a developer. The builder of the apartments required a payment guarantee before commencing work. The payment guarantee was provided by UDC. As security UDC was assigned the agreements for sale and purchase. The development was not successful and the developer was wound-up. The plaintiffs pursued UDC under section11(1) for losses arising as a result of misrepresentations made by the developer.
In the first-instance decision Master Venning was faced with a strike-out application, and it appears that it was accepted that section 11(1) of the Contractual Remedies Act 1979 applied. Wild J specifically considered the limitation on damages in section 11(2) and held that it limited damages to the value the assignor derived from the assignment, by which he appears to have meant the benefit of the performance of the contract.

Section 11(2)

The effects of section 11(2), and UDC, were also considered in SB Properties Ltd. The Court, citing an article by the late Professor Richard Sutton 20, considered that there were three ways in which the liability of the assignee to the non-assigning party could be limited. Those were:

1. The value the assignee was prepared to pay for the assignment;
2. The objective value of what the assignee receives or is entitled to received, under the assigned contract (the market value of the consideration); or
3. The amount by which the assignee is enriched by the non-assigning party’s performance of the contract (the net increase in the assignee’s net assets).

The Court endorsed the third option saying at paragraph 35 that “it does justice to the assignee, who is not liable for more than he receives, and provides a suitable limitation upon the extent of the assignee’s liability.” That approach appears to be correct, and accords with the principles behind section 11, even if it places a limitation which has not been expressly placed on the application of the common law and equitable principles already discussed.

This gives an incentive to contracting parties to include a clause increasing the liability of any assignee to the total value of any losses suffered by the non-assigning party. It also raises an interesting question about the application of section 11(2) to a situation where only the burden of a contract was assigned? In such a case, the value of the performance of the contract to the assignee is most likely nil. That would render ineffective any assignment of a burden meaning that, despite the wording of section 11(1), there has practically been no change to the common law. That is question that the courts are yet to address.

As a result, it is now beyond doubt that the Contractual Remedies Act has affirmed in statute, and clarified, the position at law, as well as expanding it, and on the same principled basis – you cannot take a benefit, without also taking the burden. A contractual burden can be assigned, in effect, because where a contract, the benefit of a contract, or the burden of a contract are assigned the other contracting party has a direct cause of action against the assignee. That cause of action will involve claiming for damages, or cancellation, based on a breach of the contract, but also for damages arising from a misrepresentation made by the assignor which is action under section 6 of the Contractual Remedies Act. In that respect, the Act extends the position that previously existed.

Conclusion

The maxim that ‘the burden of a contract cannot be assigned without a novation’ is appealing, but deceptive, in its simplicity. If the situation is one where the assignor is attempting to avoid liability by substituting in the assignee in his or her own place, then the maxim is correct. If the situation is one where the assignee is potentially to become liable as well as the assignor, then the maxim that applies is a different one – namely that he who enjoys the benefit ought also to take the burden.

That maxim has long been recognised by law, and over time a principled approach has developed to it. More particularly, where a person takes the benefit of a contract, then he or she also takes the burden of – and that occurs either by way of equity, in that assignments are taken subject to equities – or by way of operation of a principle that benefits and burdens can, sometimes, be inseparable. In such cases, the over-riding principle is that the assignee
cannot be in a better position than an assignor, and so the contract cannot be enforced by the assignee without the assignor’s obligations being fulfilled, and if the benefit is conditional on a burden, then that burden passes as well. That is only equitable to the other contracting party.

This broad principle, which has developed in the law relating to assignments, has been codified, modified and extended by the Contractual Remedies Act. It goes further than the law has developed to date, by allowing a cause of action for pre-contractual misrepresentations made by the assignor to the other contracting party. The full implications of this have only recently been grappled with by the Court of Appeal in SB Properties Ltd. Hopefully with that decision the complexities of the law of assignment will be more widely recognised, and practitioners will look behind the comments of Lord Collins MR in Tolhurst v Associated Portland Cement Manufacturers and examine the principles governing this area of the law.

[2009] NZCA 327, Baragwanath, Hugh Williams and Winkelmann JJ

2 [1902] 2 KB 660

3 Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1993] 3 All ER 417 at 427 per Lord Browne-Wilkinson

4 see the comments of Lord Greene, Davies v Collins [1945] 1 All ER 247 at 250


6 For example, Phipps v Lovegrove, Prosser v Phipps (1873) LR 16 Eq 80 at 88, or Downers v Bank of New Zealand [1995] 13 NZLR 723

7 [2002] 1 NZLR 173

8 1994] 1 NZLR 724

9 [1977] 2 All ER 741

10 This concept has long been recognised at law – on this see Davies, C.J. ‘The Principle of Benefit and Burden’, Cambridge Law Journal [1998] 522

11 Calaby Pty Ltd v Ampol Pty Ltd [1990] 71 NTR 1 at 15-16 per Angel J in the Northern Territory Supreme Court

12 [1977] 3 All ER 129

13 Law of Contract in New Zealand (3rd edition, 2007) at 560

14 Government Insurance Office (NSW) v K A Reed Services Pty Ltd [1988] VR 829

15 [1988] 1 NZLR 462

16 (1999) 4 NZ ConvC 193,024

17 High Court, Auckland, CIV-2003-404-2422, 11 September 2003

18 Impact Collections Ltd v Cornerstone Group Ltd (High Court, Auckland, AP6/99, 6 May 1999) and Southern Community Laboratories Ltd v Radius Health Ltd (High Court, Auckland, CIV-2003-404-2422, 11 September 2003)

19 [2003] 3 NZLR 192