

Under the terms of a written contract, a contractor agreed to construct a garage for a homeowner for \$10,000. Nothing was stated in the parties' negotiations or in the contract about progress payments during the course of the work. After completing 25% of the garage strictly according to the homeowner's specifications, the contractor assigned his rights under the contract to a bank as security for an \$8,000 loan. The bank immediately notified the homeowner of the assignment.

The contractor then, without legal excuse, abandoned the job before it was half-complete. The contractor subsequently defaulted on the loan from the bank. The contractor has no assets. It will cost the homeowner at least \$8,000 to get the garage finished by another builder.

If the bank sues the homeowner for \$8,000, which of the following will the court decide?

- A. The bank wins, because the bank as a secured creditor over the contractor is entitled to priority over the homeowner's unsecured claim against the contractor.
- B. The bank wins, because the contract was in existence and the contractor was not in breach when the bank gave the homeowner notice of the assignment.
- C. The homeowner wins, because her claim against the contractor arose prior to the contractor's default on his loan from the bank.
- D. The homeowner wins, because her right to recoupment on account of the contractor's breach is available against the bank as the contractor's assignee.

Explanation:

Assignment of contractual rights

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|--------------------------|---|
| Limitations | <ul style="list-style-type: none">• Assignment permitted unless it:<ul style="list-style-type: none">– materially increases obligor's contractual duties or risks– materially reduces obligor's chance of obtaining performance <i>or</i>– is void (not merely prohibited) under contract provision |
| Requirements | <ul style="list-style-type: none">• Present intent to immediately assign right• Consideration generally required to make assignment irrevocable<ul style="list-style-type: none">– Exceptions: promissory estoppel, delivery of document symbolizing assigned right (eg, stock certificate), delivery of written & signed assignment |
| Assignee's rights | <ul style="list-style-type: none">• Assumes all of assignor's rights as contract stands at time of assignment, subject to claims/defenses that:<ul style="list-style-type: none">– accrued before obligor received notice of assignment <i>or</i>– stem from assignor's present or future failure to perform• Assignor loses rights & therefore cannot enforce contract |

A party to a contract is generally **free to assign** (ie, transfer) its contractual rights to another. The recipient of those rights (assignee) then steps into the shoes of the assigning party (assignor) and **assumes** all of the assignor's **contractual rights** to the obligor's performance as they stand at the time of the assignment. However, those rights are **subject to** any **claims or defenses** that:

- **accrued *before*** the obligor received **notice of the assignment** *or*
- stem from the assignor's present or future **failure to perform (Choice B)**.

Here, the contractor assigned his contractual rights to the bank—including the right to sue the homeowner for money owed under the contract up to the amount of the bank loan (\$8,000). However, the bank's recovery is subject to the homeowner's right to recoup \$8,000 for the contractor's subsequent failure to finish the garage. Since this fully offsets the bank's recovery, the court will decide for the homeowner.

(Choice A) The priority of secured and unsecured claims is relevant in bankruptcy proceedings and other situations where claims are paid in order of priority. But here, the bank's secured-creditor status over the contractor does not affect the homeowner's right to offset the bank's recovery.

(Choice C) Had the homeowner's claim been *unrelated* to the contractor's failure to perform, the timing of the breach and when she received notice of the assignment would

affect her ability to prevail. But the time that the contractor defaulted on the bank's loan is irrelevant to her success.

Educational objective:

An assignee assumes all of the assignor's contractual rights that exist at the time of the assignment. However, the assignment is subject to any claims or defenses that (1) the obligor could have raised before receiving notice of the assignment or (2) stem from the assignor's failure to perform.

References

- Restatement (Second) of Contracts § 336 (Am. Law Inst. 1981) (defenses against assignee).

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