ASSIGNMENT AND NOVATION: SPOT THE DIFFERENCE

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The English Technology and Construction Court has found that the assignment of a sub-contract from a main contractor to an employer upon termination of an EPC contract will, in the absence of express intention to the contrary, transfer both accrued and future contractual benefits.

In doing so, Mrs Justice O'Farrell has emphasised established principles on assignment and novation, and the clear conceptual distinction between them. While this decision affirms existing authority, it also highlights the inherent risks for construction contractors in step-in assignment arrangements.

> "This decision shows the court's desire to give effect to clear contractual provisions, particularly in complex construction contracts, even where doing so puts a party in a difficult position."

BACKGROUND

This preliminary issues judgment in the matter of *Energy Works (Hull) Ltd v MW High Tech Projects UK Ltd & Others*[1], is the latest in a long series of decisions surrounding the Energy Works plant, a fluidised bed gasification energy-from-waste power plant in Hull[2]. The defendant, MW High Tech Projects UK Ltd ("MW"), was engaged as the main contractor by the claimant and employer, Energy Works (Hull) Ltd ("EWHL"), under an EPC contract entered into in November 2015. Through a sub-contract, MW engaged Outotec (USA) Inc ("Outotec") to supply key elements for the construction of the plant.

By March 2019, issues had arisen with the project. EWHL terminated the main contract for contractor default and, pursuant to a term in the EPC contract, asked MW to assign to it MW's sub-contract with Outotec. The sub-contract permitted assignment, but MW and EWHL were unable to agree a deed of assignment. Ultimately, MW wrote to EWHL and Outotec, notifying them both that it was assigning the sub-contract to EWHL. EWHL subsequently brought £133m proceedings against MW, seeking compensation for the cost of defects and delay in completion of the works. The defendant disputed the grounds of the termination, denied EWHL's claims, and sought to pass on any liability to Outotec through an additional claim under the sub-contract. Outotec disputed MW's entitlement to bring the additional claim on the grounds that MW no longer had any rights under the sub-contract, because those rights had been assigned to EWHL.

The parties accepted that a valid transfer in respect of the sub-contract had taken place. However, MW maintained that the assignment only transferred future rights under the sub-contract and that all accrued rights – which would include the right to sue Outotec for any failure to perform in accordance with the sub-contract occurring prior to the assignment – remained with MW. In the alternative, MW argued that the transfer had been intended as a novation such that all rights *and liabilities* had been transferred. As a secondary point, MW also claimed eligibility for a contribution from Outotec under the Civil Liability (Contribution) Act 1978 for their alleged partial liability[3].

ASSIGNMENT

An assignment is a transfer of a right from one party to another. Usually this is the transfer by one party of its rights and remedies, under a contract with a counterparty, to a third party. However, importantly, the assignor remains liable for any obligations it owes under the contract. As an example, Party A can assign to Party C its right to receive goods under a contract with Party B, but it will remain liable to pay Party B for those goods. Section 136 of the Law of Property Act 1926 requires a valid statutory assignment to be absolute, in writing, and on notice to the contractual counterparty.

In this case, the precise scope of the transferred rights and the purported assignment of contractual obligations were in issue. Mrs Justice O'Farrell looked to the House of Lords' decision in *Linden Gardens*[4] to set out three relevant principles on assignment:

1. Subject to any express contractual restrictions, a party to a contract can assign the benefit of a contract, but not the burden, without the consent of the other party to the contract;
2. In the absence of any clear contrary intention, reference to assignment of the contract by parties is understood to mean assignment of the benefit, that is, accrued and future rights; and
3. It is possible to assign only future rights under a contract (i.e. so that the assignor retains any rights which have already accrued at the date of the assignment), but clear words are needed to give effect to such an intention.

"In the absence of any clear contrary intention, reference to assignment of the contract by parties is understood to mean assignment of the benefit, that is, accrued and future rights."

Hence, in relation to MW's first argument, it is theoretically possible to separate future and accrued rights for assignment, but this can only be achieved through "careful and intricate drafting, spelling out the parties' intentions". The judge held that, since such wording was absent here, MW had transferred all its rights, both accrued and future, to EWHL, including its right to sue Outotec.

NOVATION

Whereas assignment only transfers a party's rights under a contract, novation transfers both a party's rights *and its obligations*. Strictly speaking, the original contract is extinguished and a new one formed between the incoming party and the remaining party to the original contract. This new contract has the same terms as the original, unless expressly agreed otherwise by the parties.

Another key difference from assignment is that novation requires the consent of all parties involved, i.e. the transferring party, the counterparty, and the incoming party. With assignment, the transferring party is only required to notify its counterparty of the assignment. Consent to a novation can be given when the original contract is first entered into. However, when giving consent to a future novation, the parties must be clear what the terms of the new contract will be.

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A novation need not be in writing. However, the desire to show that all parties have given the required consent, the use of deeds of novation to avoid questions of consideration, and the use of novation to transfer 'key' contracts, particularly in asset purchase transactions, means that they often do take written form. A properly drafted novation agreement will usually make clear whether the outgoing party remains responsible for liabilities accrued prior to the transfer, or whether these become the incoming party's problem.

As with any contractual agreement, the words used by the parties are key. Mrs Justice O'Farrell found that the use of the words "assign the sub-contract" were a strong indication that in this case the transfer was intended to be an assignment, and not a novation.

CONCLUSION

This decision reaffirms the established principles of assignment and novation and the distinction between them. It also shows the court's desire to give effect to clear contractual provisions, particularly in complex construction contracts, even where doing so puts a party in a difficult position. Here, it was found that MW had transferred away its right to pursue Outotec for damages under the sub-contract, but MW remained liable to EWHL under the EPC contract. As a result, EWHL had the right to pursue either or both of MW and Outotec for losses arising from defects in the Outotec equipment, but where it chose to pursue only MW, MW had no contractual means of recovering from Outotec any sums it had to pay to EWHL. Mrs Justice O'Farrell stressed that "it is a matter for the parties to determine the basis on which they allocate risk within the contractual matrix." A contractor in MW's position can still seek from a sub-contractor a contribution in respect of its liability to the employer under the Civil Liability (Contribution) Act 1978 (as the judge confirmed MW was entitled to do in this case). However, the wording of the Act is very specific, and it may not always be possible to pass down a contractual chain all, or any, of a party's liability.

Commercially, contractors often assume some risk of liability to the employer without the prospect of recovery from a sub-contractor, such as where the sub-contractor becomes insolvent, or where the sub-contract for some reason cannot be negotiated and agreed on back-to-back terms with the EPC contract. However, contractors need to consider carefully the ramifications of provisions allowing the transfer of sub-contracts to parties further up a contractual chain and take steps to ensure such provisions reflect any agreement as to the allocation of risk on a project.

This article was authored by London Dispute Resolution Co-Head and Partner Rebecca Williams, Senior Associate Mark McAllister-Jones and Gerard Rhodes, a trainee solicitor in the London office.

[1] [2020] EWHC 2537 (TCC)

[2] See, for example, the decisions in *Premier Engineering (Lincoln) Ltd v MW High Tech Projects UK Ltd* [2020] EWHC 2484, reported in our article here, *Engie Fabricom (UK) Ltd v MW High Tech Projects UK Ltd* [2020] EWHC 1626 (TCC) and *C Spencer Limited v MW High Tech Projects UK Limited* [2020] EWCA Civ 331, reported in our article here.

[3] The Civil Liability (Contribution) Act 1978 allows that "*any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage whether jointly with him or otherwise*."

[4] Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd [1994] 1 AC 85

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