

What to Watch Out For When Buying or Selling a Contract

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If you've entered into a contract with someone, can you transfer that contract to someone else? The answer depends on what the contract says – but there are some things to watch out for. If you're thinking of buying or selling a contract (or a whole business), read on for some pointers.

Why would you want to buy or sell a contract?

It's common to buy or sell contracts as part of buying or selling a business. As an example – imagine you have a software development business, which has contracts to develop and maintain software for your customers.

The customer contracts are probably a very important part of the business. Then you get an opportunity to sell your business to a big technology company – finally a reward for years of hard work. Let's assume you keep the company, and only sell the assets and contracts it owns.

The question then is: do you need your customers' approval to be able to sell (or "assign") those contracts to the buyer?

Do you need approval to assign contracts?

Well, it depends on the contracts themselves. Some contracts won't let you assign at all, while some contracts will let you assign however you like. The most common position you'll find is that you can assign, but only if the other person approves/consents (this is often called a "no-assignment" clause).

A no-assignment clause means that if you go ahead and sell your business without getting those approvals, you won't be able to transfer those contracts to the buyer. This means the buyer won't be happy, as they paid you for contracts that they didn't get. You'll also still be locked into performing your obligations to the customers, but without all the assets and employees you normally use – meaning you'll be at risk.

What should you do when entering contracts?

If you're in an industry where you might sell your business contracts one day, try to remove any no-assignment clause before signing.

Even if this isn't possible, you can try to understand which of your contracts have no-assignment clauses in them.

On the other side, you probably don't want your key supplier to be replaced by an unknown or incompetent business. In this case, you'll want to ensure there is a strong no-assignment clause in any important contracts.

A recent example of what can go wrong

In one recent case (the Hellaby case), a company tried to buy a contract and then enforce it, but ran into a big issue.

The case involved a builder, a client, and a buyer. The client owed a (presumably large) sum of money to the builder under a construction contract. The buyer then bought the construction contract off the builder, as part of a larger sale of the builder's business.

However, the contract was a "NZS:3910-2013" building contract (a very commonly used type of construction contract in New Zealand). Clause 2.9.1 of the contract stated that neither party could assign any part of the contract without the other party's consent. The builder did not get the client's consent before supposedly "assigning" the contract.

What happens if you don't get approval?

When the buyer tried to enforce the debt under the contract against the client, the client simply pointed to the contract. The client hadn't consented to the assignment, meaning the assignment was invalid and the client didn't have to pay.

The judge in the case made it clear the "no-assignment" clause does what it says: it prohibits assignment without consent. The case doesn't go into too much detail, but the whole saga probably cost the buyer a decent amount of money.

What does this all mean?

If you're looking at buying or selling contracts (or a business), check whether the contracts will let you assign or not. Also, whenever you enter into a contract, quickly look for any restrictions on assignment, especially if you might one day sell the business.

If the contract doesn't work for you, try to change it to something more favourable, or if that isn't possible, at least keep a record of the restriction for later. This should prevent you from being caught out if you do look to sell at a later date.

Further Advice

If you'd like further advice in regards to buying or selling a contract, please contact Wade Pearson at wade.pearson@gallawaycookallan.co.nz or 03 474 9743.

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Disclaimer: this article is general in nature and not intended to be used as a substitute for legal advice.