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Anti-Assignment Clauses; Are LLC Operating Agreements Different From Other Contracts?

February 25, 2012 by Brad Hamilton

This is a summary of a recent article by Brad Hamilton; click here for the full article.

In a little noticed case reported on December 19, 2011, Condo v. Conners, the Colorado Supreme Court issued a decision on a common contract drafting problem - the effect of an anti-assignment clause.

Historically, when contracting parties wanted to prohibit each other from assigning the contract, a lawyer would include language reading something like: "A party shall not assign, sell or otherwise transfer its rights under this agreement without the written consent of the other party."

Back in the day, that language accomplished the parties' intent, because courts held it meant that a party did not have the power to assign a contract, and any assignment without consent would be void and treated as though it never happened. That is the "classical" or "historical" rule.

Over the last 10-20 years, a new rule has developed; some courts have held that language prohibiting assignment does not mean the parties can't assign, it means that if they do it is a breach of the contract, but the assignment still stands. Under the new rule if a party assigns the contract without consent and in breach of the contract language, the other party could not bring an action to void or ignore the assignment, but could only bring an action for damages - a very bad outcome for someone who simply doesn't want to be in a contract with a party he didn't choose! Moreover, in most situations it is very difficult to measure and prove damages arising from a prohibited assignment.

Anti-assignment clauses are found in many types of contracts, but are particularly important in contracts where people are going into business together, like partnership agreements, joint venture agreements and limited liability company operating agreements.

In Condo v. Conners, three people formed a Colorado limited liability company and signed an operating agreement that said "a member shall not sell, assign, pledge or otherwise transfer any portion of its interest in [the Company] without the prior written approval of all of the Members". One of the members got a divorce, and as part of the divorce settlement he tried to assign his membership interest to his wife. The other two members did not consent, so he assigned his wife only the right to receive distributions, and also agreed to follow her instructions when voting his membership interest. When he later sold his membership interest to his partners, his ex-wife sued to void the sale and enforce the earlier assignment to her.

The outcome of the case hinged on the new rule versus classic rule debate - if the new rule applies, the assignment to the ex-wife in violation of the operating agreement is not void, but the two partners would have a breach of contract claim against the husband - the wife wins. If the classic rule applies, the wife loses because the assignment to the wife in violation of the operating agreement would be void and treated as though it never happened.

The dispute made it to the Colorado Supreme Court, who had to decide whether to apply the modern rule and let the assignment stand, or apply the classical rule and void the assignment. Instead of adopting a hard and fast rule for the interpretation of anti-assignment clauses, or even anti-assignment clauses only in operating agreements, the Supreme Court held that either rule might apply to a contract under Colorado law, and which rule applies can only be determined by discerning the intent of the parties and the facts of a specific case. In THIS CASE, the Supreme Court applied the classical rule, holding the assignment by the husband to his wife was void because the language of the operating agreement, read in conjunction with the language of the statute, indicated that the parties wanted to restrict who they would do business with and prevent any assignment without consent.

The lessons from this decision are not new. Courts seldom adopt a hard and fast rule when it is unnecessary to decide the case before them - doing so often invokes the law of unintended consequences, and restricts the flexibility of courts to fashion justice in other cases. It is up to the parties to say what they want. Since at least 2003 and possibly earlier, legal commentators have been advising lawyers who want to strictly prohibit assignment of a contract to address this very issue. In Negotiating and Drafting Contract Boilerplate (ALM Publishing 2003), Tina Stark dedicates an entire chapter to this issue (Chapter 3, Assignment and Delegation).

Recommendation

An anti-assignment clause in an important contract should not be thrown in as "standard language" or culled from form boilerplate. If you might want to assign the contract or certain rights or obligations in the future, but don't want to raise the issue during negotiations, then vague language of the type used in Condo v. Conners may be best - leave that fight for another day. But if it is important to you that the contract not be assigned, language of the following type will avoid the analysis and uncertainty reflected in Condo v. Conners:

"No party may assign its rights or delegate its obligations under this Agreement, without the written consent of the other party. Any purported assignment or delegation in breach of the preceding sentence shall be void."

Problem solved!

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