

Assignment and Delegation

Intended third-party beneficiaries acquire rights because of the mutual decision of the parties when forming (or modifying) their contract. By contrast, the third parties that are discussed in this section enter the contractual relationship when the contract is already in existence, and one party then either assigns its rights, or delegates its duties (or both) to a third party.

Assignments and delegation are more common than you might expect. You probably have seen them already in our studies of contract law. Remember, for example, *Hamer v. Sideway*, where a person named Hamer sued a person named Sideway over a contract that was allegedly entered into by two people named Story. How did that happen? You guessed it: Assignment! The younger Story assigned its right to be paid to his wife, who then assigned it to Hammer. (Sideway was the executor of the uncle's estate, a process that we typically don't call assignment but has many similarities.) We saw assignments and delegations in other famous contract law cases including *Olson v. Etheridge* in the section on third-party beneficiaries.

Assignment and delegation occur in many common situations, and while some of them are governed by the basic rules of contract law that this section explores, many of them involve legal issues that go beyond the scope of a contract law course. Consider the type of assignments that are extremely common in our modern credit economy: Alan, a general contractor, built Britany a house for \$100,000. Their contract provides that she will pay 30 days after the project is complete. Alan, however, needs cash immediately to pay his subcontractors and suppliers, and, therefore, might like to take a loan to finance his operation. The lender, however, would much prefer to provide that loan (and will give Alan better terms) if Alan, in return, assigns his rights to be paid by Britany. Contract law controls his ability to do so.

In order to reduce its risk even further, and provide Alan with even better terms, the lender can undertake a legal process called perfection of a security interest. Perfecting the security interest will better guarantee the lender's rights, especially by giving it priority over many of Alan's other creditors. This process, which centers on giving public notice of the lender's priority against others, is governed by Article 9 of the UCC.

Bankruptcy is another situation where contracts are typically assigned and delegated, first to the executor of the debtor's estate, and then, by the executor, to others as a way to generate income for the creditors. The rules regarding assignment and delegation in bankruptcy are

affected by contract law but also by bankruptcy law, and in particular by Title 11 of the United States Code, commonly referred to as “the Bankruptcy Code.”

Assignments can also occur with respect to negotiable instruments. Charlie buys Dana’s laptop by giving her a piece of paper—what laymen call a check and lawyers call a negotiated instrument—that instructs his bank to pay Dana \$800. This by itself is likely to be considered an assignment (do you see why?), but things can get even more complex when Dana buys Ed’s bike for \$800, which she pays for by giving Charlie’s check to Ed. Those transactions in which a duty to pay is transferred from one person to another are mostly governed by Article 3 of the UCC (we will say something about negotiable instruments later in this section, but this complex topic is typically studied in an advanced course on commercial law).

M&A transactions—when one corporation buys another—typically entail a host of assignments and delegations as the new entity takes over the rights and obligations of the older one. Those types of assignments and delegations are controlled, for the most part, by contract law. In fact, the first case in this section arose in the context of an M&A transaction.

Delegations are extremely common when the contract entails complex undertakings. Most significant endeavors in our society require individuals to use their distinguished expertise, and this division of labor is often facilitated by a series of delegations. In fact, corporations almost always perform their contractual obligations through their managers, employees, and contractors. Construction projects also often require delegations of duties, for example, from the general contractor to each of its sub-contractors.

All those examples show how important the ability to assign and delegate contracts is. Contracting parties and society at large have a strong interest in the *free alienability* of contractual rights and duties, which makes the contract more flexible and valuable. This economic reality affected the law as well. While the common law used to be quite hostile to assignments and delegations, in the last few decades, those transactions are commonly recognized, enforced, and even encouraged.

Nevertheless, alienability of rights and obligations entails risk. The original parties to the contract often have an interest in the stability of their contractual rights and obligations. If a right to receive performance is assigned, the obligor may face somewhat different obligations. For example, if Amy agreed to take care of Billy’s pet for a week, knowing that he owns a cute puppy, then she might not appreciate it if Billy assigns his rights to Carrol, who owns a mean

tiger. Similarly, delegation can change the type of performance that the obligee receives from what she bargained for. For example, most would prefer that a famous painter would not delegate her duty to paint their portraits to an art student. The rules of assignment and delegation aim to balance those conflicting interests.

Before we begin, a preliminary note on terminology: In this section, it is important that you distinguish between a party's contractual rights and contractual duties, as the rights can be assigned, and the duties can be delegated. Unfortunately, in drafting practice, it is common to use the term "assignment" or "assignability" also to refer to the transfer of duties or to both rights and duties. At times, courts use such confusing terminology too. However, because the assignment of rights and the delegation of duties are subject to different rules and policies, it is better to keep them separated. As you can expect, the use of inaccurate terminology can lead to ambiguity, a topic we will tackle later in this section.

When are Assignments and Delegations Valid

The starting point of both the Restatement and the UCC is that, subject to certain exceptions, assignments and delegations are allowed. Restatement (Second) of Contracts §§ 317(2), 318(1); UCC § 2-210(1), (2). Both the rules regarding assignment of rights and those concerning delegation of duties aim to give the parties the ability to create flexible arrangements while also protecting the basic framework of their bargained-for contract.

Under both the Restatement and the UCC, there are three categories of exceptions to the right to assign and delegate: those that are rooted in statutory law, those that are rooted in the contract, and those that courts use when there is no guidance in statutory law or in the contract.

Statutory law might limit assignability and delegations or explicitly allow them. For example, in an attempt to protect weak members of society, state laws significantly restrict the ability of employees to assign their unearned salaries. On the other hand, the UCC states that "[a] right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise." UCC § 2-210 (2). Therefore, regardless of the parties' contract, a seller who already delivered the goods can always assign its right to be paid.

Assuming no statute prohibits or explicitly allows a certain assignment or delegation, the next question is whether the contract explicitly prohibits or allows it. We will discuss those

contractual provisions later in this section, but, for now, suffice to say that courts generally allow parties to set their own arrangements regarding future assignment and delegation. As the Restatement notes, “[e]ven where delegation is normal, a particular contract may call for personal performance. Or the contract may permit delegation where personal performance is normally required.” Restatement (Second) of Contracts § 318, cmt. c. However, as we will further see below, the public policy preferring alienability, and in particular assignability, leads courts to interpret contractual restrictions narrowly. *See id.*, § 317, cmt. f.

When both the statute and the contract are silent on assignability and delegation, it is up to the court to decide if the parties’ bargained-for interests are materially impacted by the attempted assignment or delegation of the other party.

When it comes to an assignment, both the Restatement and the UCC aim to protect the obligor against material changes. The Restatement suggests that any attempted assignment is invalid if it “would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him.” Restatement (Second) of Contracts § 317(a)(1). Similarly, the UCC prohibits assignability “where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance.” UCC § 2-210(2). In practice, unless the contract states otherwise, courts rarely rule an assignment invalid.

The Restatement prohibits delegations that are against public policy or where “the obligee has a substantial interest in having that person perform or control the acts promised.” Restatement (Second) of Contracts § 318(2). The UCC, almost identically, prohibits delegation when a party “has a substantial interest in having his original promisor perform or control the acts required by the contract.” UCC § 2-210(1). Courts are somewhat more inclined to prohibit delegation than assignment, although, here too, the general public policy and the trend in modern caselaw is to permit alienability, including delegation.

It is crucial to note that there is a fundamental difference between the legal consequences of assignments and delegations. Assignment transfers the right from the assignor to the assignee, thus extinguishing the right of the assignor. *See* Restatement (Second) of Contracts § 317(1) (“An assignment of a right is a manifestation of the assignor’s intention to transfer it by virtue of which the assignor’s right to performance by the obligor is extinguished in whole or in part and the assignee acquires a right to such performance.”). A delegation, however, does not

discard the delegator's duty unless *explicitly* released by the obligee (a process called novation). See Restatement (Second) of Contracts § 318(3), UCC § 2-210(1). Therefore, if Amber, Blake's general contractor, enters a contract with her subcontractor Chris in which she delegates the painting of Blake's house, and Chris fails to perform, Blake has a cause of action against Amber. Moreover, Blake likely has a cause of action against Chris as well as an intended third-party beneficiary of Chris's contract with Amber.

Sally Beauty Co., Inc. v. Nexxus Products Co., Inc.

801 F.2d 1001 (7th Cir. 1986)

CUDAHY, Circuit Judge.

Nexxus Products Company ("Nexxus") entered into a contract with Best Barber & Beauty Supply Company, Inc. ("Best"), under which Best would be the exclusive distributor of Nexxus hair care products to barbers and hair stylists throughout most of Texas. When Best was acquired by and merged into Sally Beauty Company, Inc. ("Sally Beauty"), Nexxus cancelled the agreement. Sally Beauty is a wholly-owned subsidiary of Alberto-Culver Company ("Alberto-Culver"), a major manufacturer of hair care products and a competitor of Nexxus'. Sally Beauty claims that Nexxus breached the contract by cancelling; Nexxus asserts by way of defense that the contract was not assignable or, in the alternative, not assignable to Sally Beauty. The district court granted Nexxus' motion for summary judgment, ruling that the contract was one for personal services and therefore not assignable. We affirm on a different theory—that this contract could not be assigned to the wholly-owned subsidiary of a direct competitor under section 2–210 of the Uniform Commercial Code.

I.

Only the basic facts are undisputed and they are as follows. Prior to its merger with Sally Beauty, Best was a Texas corporation in the business of distributing beauty and hair care products to retail stores, barber shops and beauty salons throughout Texas. Between March and July 1979, Mark Reichek, Best's president, negotiated with Stephen Redding, Nexxus' vice-president, over a possible distribution agreement between Best and Nexxus. Nexxus, founded in 1979, is a California corporation that formulates and markets hair care products. Nexxus does not market its products to retail stores, preferring to sell them to independent distributors for resale to barbers and beauticians. On August 2, 1979, Nexxus executed a distributorship

agreement with Best, in the form of a July 24, 1979 letter from Reichek, for Best, to Redding, for Nexxus.

[The court quotes the agreement in full. It discusses the distribution arrangement and does not say anything about assignment or delegation. It required 120 days advance notice for termination of the agreement.]

In July 1981 Sally Beauty acquired Best in a stock purchase transaction and Best was merged into Sally Beauty, which succeeded to Best's rights and interests in all of Best's contracts. Sally Beauty, a Delaware corporation with its principal place of business in Texas, is a wholly-owned subsidiary of Alberto-Culver. Sally Beauty, like Best, is a distributor of hair care and beauty products to retail stores and hair styling salons. Alberto-Culver is a major manufacturer of hair care products and, thus, is a direct competitor of Nexxus in the hair care market.

Shortly after the merger, Redding met with Michael Renzulli, president of Sally Beauty, to discuss the Nexxus distribution agreement. After the meeting, Redding wrote Renzulli a letter stating that Nexxus would not allow Sally Beauty, a wholly-owned subsidiary of a direct competitor, to distribute Nexxus products:

As we discussed in New Orleans, we have great reservations about allowing our NEXXUS Products to be distributed by a company which is, in essence, a direct competitor. We appreciate your argument of autonomy for your business, but the fact remains that you are totally owned by Alberto-Culver.

Since we see no way of justifying this conflict, we cannot allow our products to be distributed by Sally Beauty Company.

II.

Sally Beauty's breach of contract claim alleges that by acquiring Best, Sally Beauty succeeded to all of Best's rights and obligations under the distribution agreement. It further alleges that Nexxus breached the agreement by failing to give Sally Beauty 120 days notice prior to terminating the agreement ... Nexxus, in its motion for summary judgment, argued that the distribution agreement it entered into with Best was a contract for personal services, based upon a relationship of personal trust and confidence between Reichek and the Redding family. As such, the contract could not be assigned to Sally without Nexxus' consent.

In opposing this motion Sally Beauty argued that the contract was freely assignable because (1) it was between two corporations, not two individuals and (2) the character of the performance would not be altered by the substitution of Sally Beauty for Best. It also argued that “the Distribution Agreement is nothing more than a simple, non-exclusive contract for the distribution of goods, the successful performance of which is in no way dependent upon any particular personality, individual skill or confidential relationship.”

In ruling on this motion, the district court framed the issue before it as “whether the contract at issue here between Best and Nexxus was of a personal nature such that it was not assignable without Nexxus’ consent.” It ruled:

The court is convinced, based upon the nature of the contract and the circumstances surrounding its formation, that the contract at issue here was of such a nature that it was not assignable without Nexxus’s consent. First, the very nature of the contract itself suggests its personal character. A distribution agreement is a contract whereby a manufacturer gives another party the right to distribute its products. It is clearly a contract for the performance of a service. In the court’s view, the mere selection by a manufacturer of a party to distribute its goods presupposes a reliance and confidence by the manufacturer on the integrity and abilities of the other party

In addition, in this case the circumstances surrounding the contract’s formation support the conclusion that the agreement was not simply an ordinary commercial contract but was one which was based upon a relationship of personal trust and confidence between the parties. Specifically, Stephen Redding, Nexxus’s vice-president, travelled to Texas and met with Best’s president personally for several days before making the decision to award the Texas distributorship to Best. Best itself had been in the hair care business for 40 years and its president Mark Reichel had extensive experience in the industry.

It is reasonable to conclude that Stephen Redding and Nexxus would want its distributor to be experienced and knowledgeable in the hair care field and that the selection of Best was based upon personal factors such as these.

The district court also rejected the contention that the character of performance would not be altered by a substitution of Sally Beauty for Best: “Unlike Best, Sally Beauty is a subsidiary of one of Nexxus’ direct competitors. This is a significant distinction and in the court’s view, it

raises serious questions regarding Sally Beauty's ability to perform the distribution agreement in the same manner as Best."

We cannot affirm this summary judgment on the grounds relied on by the district court. Under Fed.R.Civ.P. 56(c) summary judgment may be granted only where there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. The burden on the movant is stringent: "all doubts as to the existence of material fact must be resolved against the movant." *Moore v. Marketplace Restaurant, Inc.*, 754 F.2d 1336, 1339 (7th Cir. 1985), quoting *Dreher v. Sielaff*, 636 F.2d 1141, 1143 n. 4 (7th Cir. 1980). Nexxus did not meet its burden on the question of the parties' reasons for entering into this agreement. Although it might be "reasonable to conclude" that Best and Nexxus had based their agreement on "a relationship of personal trust and confidence," and that Reichel's participation was considered essential to Best's performance, this is a finding of fact. Since the parties submitted conflicting affidavits on this question, the district court erred in relying on Nexxus' view as representing undisputed fact in ruling on this summary judgment motion.

We may affirm this summary judgment, however, on a different ground if it finds support in the record. Sally Beauty contends that the distribution agreement is freely assignable because it is governed by the provisions of the Uniform Commercial Code (the "UCC" or the "Code"), as adopted in Texas. We agree with Sally that the provisions of the UCC govern this contract and for that reason hold that the assignment of the contract by Best to Sally Beauty was barred by the UCC rules on delegation of performance, UCC § 2-210(1), Tex. Bus. & Com. Code Ann. § 2-210(a).

III.

The UCC codifies the law of contracts applicable to "transactions in goods." UCC § 2-102. Texas applies the "dominant factor" test to determine whether the UCC applies to a given contract or transaction: was the essence of or dominant factor in the formation of the contract the provision of goods or services? ... No Texas case addresses whether a distribution agreement is a contract for the sale of goods, but the rule in the majority of jurisdictions is that distributorships (both exclusive and non-exclusive) are to be treated as sale of goods contracts under the UCC ...

Several of these courts note that "a distributorship agreement is more involved than a typical sales contract," *Quality Performance Lines*, 609 P.2d at 1342, but apply the UCC nonetheless because the sales aspect in such a contract is predominant... this is true of the contract at issue here... We are

confident that a Texas court would find the sales aspect of this contract dominant and apply the majority rule that such a distributorship is a contract for “goods” under the UCC.

IV.

The fact that this contract is considered a contract for the sale of goods and not for the provision of a service does not, as Sally Beauty suggests, mean that it is freely assignable in all circumstances. The delegation of performance under a sales contract (whether in conjunction with an assignment of rights, as here, or not) is governed by UCC section 2–210(1). The UCC recognizes that in many cases an obligor will find it convenient or even necessary to relieve himself of the duty of performance under a contract, see Official Comment 1, UCC § 2–210 (“[T]his section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.”). The Code therefore sanctions delegation except where the delegated performance would be unsatisfactory to the obligee: “A party may perform his duty through a delegate unless otherwise agreed to or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract.” UCC § 2–210(1). Consideration is given to balancing the policies of free alienability of commercial contracts and protecting the obligee from having to accept a bargain he did not contract for.

We are concerned here with the delegation of Best’s duty of performance under the distribution agreement, as Nexxus terminated the agreement because it did not wish to accept Sally Beauty’s substituted performance. Only one Texas case has construed section 2–210 in the context of a party’s delegation of performance under an executory contract. In *McKinnie v. Milford*, 597 S.W.2d 953 (Tex. Civ. App. 1980, writ ref’d, n.r.e.), the court held that nothing in the Texas Business and Commercial Code prevented the seller of a horse from delegating to the buyer a pre-existing contractual duty to make the horse available to a third party for breeding. “[I]t is clear that Milford [the third party] had no particular interest in not allowing Stewart [the seller] to delegate the duties required by the contract. Milford was only interested in getting his two breedings per year, and such performance could only be obtained from McKinnie [the buyer] after he bought the horse from Stewart.” *Id.* at 957. In *McKinnie*, the Texas court recognized and applied the UCC rule that bars delegation of duties if there is some reason why the non-assigning party would find performance by a delegate a substantially different thing than what he had bargained for.

In the exclusive distribution agreement before us, Nexxus had contracted for Best's "best efforts" in promoting the sale of Nexxus products in Texas. UCC § 2–306(2), states that "[a] lawful agreement by either buyer or seller for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale." This implied promise on Best's part was the consideration for Nexxus' promise to refrain from supplying any other distributors within Best's exclusive area. See Official Comment 5, UCC § 2–306. It was this contractual undertaking which Nexxus refused to see performed by Sally.

In ruling on Nexxus' motion for summary judgment, the district court noted: "Unlike Best, Sally Beauty is a subsidiary of one of Nexxus' direct competitors. This is a significant distinction and in the court's view, it raises serious questions regarding Sally Beauty's ability to perform the distribution agreement in the same manner as Best." In *Berliner Foods Corp. v. Pillsbury Co.*, 633 F. Supp. 557 (D. Md. 1986), the court stated the same reservation more strongly on similar facts. Berliner was an exclusive distributor of Haagen-Dazs ice cream when it was sold to Breyer's, manufacturer of a competing ice cream line. Pillsbury Co., manufacturer of Haagen-Dazs, terminated the distributorship and Berliner sued. The court noted, while weighing the factors for and against a preliminary injunction, that "it defies common sense to require a manufacturer to leave the distribution of its products to a distributor under the control of a competitor or potential competitor." *Id.* at 559–60.⁷ We agree with these assessments and hold that Sally Beauty's position as a wholly-owned subsidiary of Alberto-Culver is sufficient to bar the delegation of Best's duties under the agreement.

We do not believe that our holding will work the mischief with our national economy that the appellants predict. We hold merely that the duty of performance under an exclusive distributorship may not be delegated to a competitor in the market place—or the wholly-owned subsidiary of a competitor—without the obligee's consent. We believe that such a rule is consonant with the policies behind section 2–210, which is concerned with preserving the bargain the obligee has struck.

Nexxus should not be required to accept the "best efforts" of Sally Beauty when those efforts are subject to the control of Alberto-Culver. It is entirely reasonable that Nexxus should conclude that this performance would be a different thing than what it had bargained for. At oral argument, Sally Beauty argued that the case should go to trial to allow it to demonstrate that it could and would perform the contract as impartially as Best. It stressed that Sally Beauty is a "multi-line" distributor, which means that it distributes many brands and is not just a

conduit for Alberto-Culver products. But we do not think that this creates a material question of fact in this case. When performance of personal services is delegated, the trier merely determines that it is a personal services contract. If so, the duty is *per se* nondelegable. There is no inquiry into whether the delegate is as skilled or worthy of trust and confidence as the original obligor: the delegate was not bargained for and the obligee need not consent to the substitution. And so here: it is undisputed that Sally Beauty is wholly owned by Alberto-Culver, which means that Sally Beauty's "impartial" sales policy is at least acquiesced in by Alberto-Culver—but could change whenever Alberto-Culver's needs changed.

Sally Beauty may be totally sincere in its belief that it can operate "impartially" as a distributor, but who can guarantee the outcome when there is a clear choice between the demands of the parent-manufacturer, Alberto-Culver, and the competing needs of Nexxus? The risk of an unfavorable outcome is not one which the law can force Nexxus to take. Nexxus has a substantial interest in not seeing this contract performed by Sally Beauty, which is sufficient to bar the delegation under section 2–210. Because Nexxus should not be forced to accept performance of the distributorship agreement by Sally, we hold that the contract was not assignable without Nexxus' consent.

The judgment of the district court is **AFFIRMED**.

POSNER, Circuit Judge, dissenting.

My brethren have decided, with no better foundation than judicial intuition about what businessmen consider reasonable, that the Uniform Commercial Code gives a supplier an absolute right to cancel an exclusive-dealing contract if the dealer is acquired, directly or indirectly, by a competitor of the supplier. I interpret the Code differently...

My brethren conclude that because there is at least a loose competitive relationship between Nexxus and Alberto-Culver, Sally Beauty cannot ... provide its "best efforts" in the distribution of Nexxus products. Since a commitment to provide best efforts is read into every exclusive-dealing contract by section 2–306(2) of the Uniform Commercial Code, the contract has been broken and Nexxus can repudiate it. Alternatively, Nexxus had "a substantial interest in having his original promisor perform or control the acts required by the contract," and therefore the delegation of the promisor's (Best's) duties to Sally Beauty was improper under section 2–210(1).

My brethren's conclusion that these provisions of the Uniform Commercial Code entitled Nexxus to cancel the contract does not leap out from the language of the provisions or of the contract; so one would expect, but does not find, a canvass of the relevant case law. My brethren cite only one case in support of their conclusion...

Sally Beauty, though a wholly owned subsidiary of Alberto-Culver, distributes "hair care" supplies made by many different companies, which so far as appears compete with Alberto-Culver as vigorously as Nexxus does. Steel companies both make fabricated steel and sell raw steel to competing fabricators. General Motors sells cars manufactured by a competitor, Isuzu. What in law would be considered a fatal conflict of interest is in business a commonplace and legitimate practice.

How likely is it that the acquisition of Best could hurt Nexxus? Not very. Suppose Alberto-Culver had ordered Sally Beauty to go slow in pushing Nexxus products, in the hope that sales of Alberto-Culver "hair care" products would rise. Even if they did, since the market is competitive Alberto-Culver would not reap monopoly profits. Moreover, what guarantee has Alberto-Culver that consumers would be diverted from Nexxus to it, rather than to products closer in price and quality to Nexxus products? In any event, any trivial gain in profits to Alberto-Culver would be offset by the loss of goodwill to Sally Beauty; and a cost to Sally Beauty is a cost to Alberto-Culver, its parent. Remember that Sally Beauty carries beauty supplies made by other competitors of Alberto-Culver; Best alone carries "hair care" products manufactured by Revlon, Clairol, Bristol-Myers, and L'Oreal, as well as Alberto-Culver. Will these powerful competitors continue to distribute their products through Sally Beauty if Sally Beauty displays favoritism for Alberto-Culver products? Would not such a display be a commercial disaster for Sally Beauty, and hence for its parent, Alberto-Culver? Is it really credible that Alberto-Culver would sacrifice Sally Beauty in a vain effort to monopolize the "hair care" market, in violation of section 2 of the Sherman Act? Is not the ratio of the profits that Alberto-Culver obtains from Sally Beauty to the profits it obtains from the manufacture of "hair care" products at least a relevant consideration?

Another relevant consideration is that the contract between Nexxus and Best was for a short term. Could Alberto-Culver destroy Nexxus by failing to push its products with maximum vigor in Texas for a year? In the unlikely event that it could and did, it would be liable in damages to Nexxus for breach of the implied best-efforts term of the distribution contract. Finally, it is obvious that Sally Beauty does not have a bottleneck position in the distribution of "hair care" products, such that by refusing to promote Nexxus products vigorously it could

stifle the distribution of those products in Texas; for Nexxus has found alternative distribution that it prefers—otherwise it wouldn't have repudiated the contract with Best when Best was acquired by Sally Beauty.

Not all businessmen are consistent and successful profit maximizers, so the probability that Alberto-Culver would instruct Sally Beauty to cease to push Nexxus products vigorously in Texas cannot be reckoned at zero. On this record, however, it is slight. And there is no principle of law that if something happens that trivially reduces the probability that a dealer will use his best efforts, the supplier can cancel the contract. Suppose there had been no merger, but the only child of Best's president had gone to work for Alberto-Culver as a chemist. Could Nexxus have canceled the contract, fearing that Best (perhaps unconsciously) would favor Alberto-Culver products over Nexxus products? That would be an absurd ground for cancellation, and so is Nexxus's actual ground. At most, so far as the record shows, Nexxus may have had grounds for "insecurity" regarding the performance by Sally Beauty of its obligation to use its best efforts to promote Nexxus products, but if so its remedy was not to cancel the contract but to demand assurances of due performance. See UCC § 2-609; Official Comment 5 to § 2-306. No such demand was made. An anticipatory repudiation by conduct requires conduct that makes the repudiating party unable to perform. The merger did not do this. At least there is no evidence it did. The judgment should be reversed and the case remanded for a trial on whether the merger so altered the conditions of performance that Nexxus is entitled to declare the contract broken.

Notes and Questions

1. The district court and the Seventh Circuit reached the same result using different reasoning. The district court saw this as a contract for personal service. Contracts for personal services cannot be delegated per se. The Seventh Circuit affirmed because the identity of the delegatee (Sally Beauty) increased the obligee's (Nexxus) risk. Which conclusion makes more sense?
2. Richard Posner, the dissenting judge, is one of the most prominent law & economic scholars of the 20th century. Can that, by itself, explain why he disagreed with the majority? Can an economic argument be made to support the majority opinion?

Allhusen v. Caristo Constr. Corp.

103 N.E.2d 891 (NY Court of Appeals 1952)

FROESSEL, Circuit Judge.

Defendant, a general contractor, subcontracted with the Kroo Painting Company (hereinafter called Kroo) for the performance by the latter of certain painting work in New York City public schools. Their contracts contained the following prohibitory provision: "The assignment by the second party [Kroo] of this contract or any interest therein, or of any money due or to become due by reason of the terms hereof without the written consent of the first party [defendant] shall be void." Kroo subsequently assigned certain rights under the contracts to Marine Midland Trust Company of New York, which in turn assigned said rights to plaintiff. These rights included the "moneys due and to become due" to Kroo. The contracts were not assigned, and no question of improper delegation of contractual duties is involved. No written consent to the assignments was procured from defendant.

Plaintiff as assignee seeks to recover, in six causes of action, \$11,650 allegedly due and owing for work done by Kroo. Defendant answered with denials, and by way of defense set up the afore-mentioned prohibitory clause, in addition to certain setoffs and counterclaims, alleged to have existed at the time of the assignments. It thereupon moved for summary judgment [which the trial court granted]. The Appellate Division affirmed, one Justice dissenting on the ground that the "account receivable was assignable by nature, and could not be rendered otherwise without imposing an unlawful restraint upon the power of alienation of property."

Whether an anti-assignment clause is effective is a question that has troubled the courts not only of this State but in other jurisdictions as well ...

Our courts have not construed a contractual provision against assignments framed in the language of the clause now before us. Such kindred clauses as have been subject to interpretation usually have been held to be either (1) personal covenants limiting the covenantee to a claim for damages in the event of a breach, or (2) ineffectual because of the use of uncertain language. But these decisions are not to be read as meaning that there can be no enforceable contractual prohibition against the assignment of a claim; indeed, they are authority only for the proposition that, in the absence of language clearly indicating that a contractual right thereunder shall be nonassignable, a prohibitory clause will be interpreted as a personal covenant not to assign...

In the light of the foregoing, we think it is reasonably clear that, while the courts have striven to uphold freedom of assignability, they have not failed to recognize the concept of freedom to contract. In large measure they agree that, where appropriate language is used, assignments of money due under contracts may be prohibited... We have now before us a clause embodying clear, definite and appropriate language, which may be construed in no other way but that any attempted assignment of either the contract or any rights created thereunder shall be “void” as against the obligor. One would have to do violence to the language here employed to hold that it is merely an agreement by the subcontractor not to assign. The objectivity of the language precludes such a construction. We are therefore compelled to conclude that this prohibitory clause is a valid and effective restriction of the right to assign.

Judgment AFFIRMED.

Notes and Questions

1. Contractual prohibitions on an otherwise valid assignment need to explicitly state that the assignment is invalid or void. Otherwise, courts might hold that either the anti-assignment provision is vague, and thus public policy considerations might make the assignment unproblematic, or that the assignment is a breach of the contract by the assignor but yet valid. In *Allbusen*, for example, the court held that the contract clearly made the assignment void. What would be the implications if the court would have held the assignment in *Allbusen* valid but in breach of the contract?
2. As noted, while the Restatement and the UCC use “assignment” to refer to the transfer of contractual rights, others often use the term inaccurately. For example, many agreements include a provision that prohibits the “assignment of the contract.” The question is whether such a prohibition refers to the assignment of rights, delegation of duties, or both.

Court and statutory law developed default rules to answer this question. If an agreement prohibits assignment of “the contract,” then unless the circumstances indicate otherwise, the court will interpret it as a prohibition just on delegation. Restatement (Second) § 322 (a); UCC § 2-210(4). On the other hand, if the assignor assigns “the contract,” “all my rights under the contract,” or uses a similar phrase, then unless the language or the circumstances indicate otherwise, courts will perceive the act as an assignment of the right and a delegation of the unperformed obligations under

the contract. Unless the language or the circumstances indicate otherwise, an acceptance of such assignment by the assignee constitutes a promise from the assignee to the assignor to perform those obligations. The other party, the obligee of those obligations, can enforce the assignee's promise as an intended third-party beneficiary. Restatement (Second) § 328; UCC § 2-210(5).

3. What is the effect of the following provisions?
- a. "Neither party may assign the contract."
 - b. "Neither party may assign its rights under the contract."
 - c. "Neither party may delegate its duties under the contract."
 - d. "Neither party may assign its rights or delegate its duties under the contract."
 - e. "Any attempt at assignment of the contract by any party is void."
 - f. "Any attempt at assignment of rights or delegation of duties under the contract by any party is void."

Herzog v. Irace

594 A.2d 1106 (Maine Supreme Judicial Court 1991)

BRODY, Justice.

Anthony Irace and Donald Lowry appeal from an order entered by the Superior Court affirming a District Court judgment in favor of Dr. John P. Herzog in an action for breach of an assignment to Dr. Herzog of personal injury settlement proceeds¹ collected by Irace and Lowry, both attorneys, on behalf of their client, Gary G. Jones. On appeal, Irace and Lowry contend that the District Court erred in finding that the assignment was valid and enforceable

¹ This case involves the assignment of proceeds from a personal injury action, not an assignment of the cause of action itself.

against them. They also argue that enforcement of the assignment interferes with their ethical obligations toward their client. Finding no error, we affirm.

The facts of this case are not disputed. Gary Jones was injured in a motorcycle accident and retained Irace and Lowry to represent him in a personal injury action. Soon thereafter, Jones dislocated his shoulder, twice, in incidents unrelated to the motorcycle accident. Dr. Herzog examined Jones's shoulder and concluded that he needed surgery. At the time, however, Jones was unable to pay for the surgery and in consideration for the performance of the surgery by the doctor, he signed a letter dated June 14, 1988, written on Dr. Herzog's letterhead stating:

I, Gary Jones, request that payment be made directly from settlement of a claim currently pending for an unrelated incident, to John Herzog, D.O., for treatment of a shoulder injury which occurred at a different time.

Dr. Herzog notified Irace and Lowry that Jones had signed an "assignment of benefits" from the motorcycle personal injury action to cover the cost of surgery on his shoulder and was informed by an employee of Irace and Lowry that the assignment was sufficient to allow the firm to pay Dr. Herzog's bills at the conclusion of the case. Dr. Herzog performed the surgery and continued to treat Jones for approximately one year.

In May, 1989, Jones received a \$20,000 settlement in the motorcycle personal injury action. He instructed Irace and Lowry not to disburse any funds to Dr. Herzog indicating that he would make the payments himself. Irace and Lowry informed Dr. Herzog that Jones had revoked his permission to have the bill paid by them directly and indicated that they would follow Jones's directions. Irace and Lowry issued a check to Jones for \$10,027 and disbursed the remaining funds to Jones's other creditors. Jones did send a check to Dr. Herzog but the check was returned by the bank for insufficient funds and Dr. Herzog was never paid.

Dr. Herzog filed a complaint in District Court against Irace and Lowry seeking to enforce the June 14, 1988 "assignment of benefits." The court entered a judgment in favor of Dr. Herzog finding that the June 14, 1988 letter constituted a valid assignment of the settlement proceeds enforceable against Irace and Lowry. Following an unsuccessful appeal to the Superior Court, Irace and Lowry appealed to this court...

Validity of Assignment

An assignment is an act or manifestation by the owner of a right (the assignor) indicating his intent to transfer that right to another person (the assignee). For an assignment to be valid and enforceable against the assignor's creditor (the obligor), the assignor must make clear his intent to relinquish the right to the assignee and must not retain any control over the right assigned or any power of revocation. The assignment takes effect through the actions of the assignor and assignee and the obligor need not accept the assignment to render it valid.

Once the obligor has notice of the assignment, the fund is "from that time forward impressed with a trust; it is ... impounded in the [obligor's] hands, and must be held by him not for the original creditor, the assignor, but for the substituted creditor, the assignee. After receiving notice of the assignment, the obligor cannot lawfully pay the amount assigned either to the assignor or to his other creditors and if the obligor does make such a payment, he does so at his peril because the assignee may enforce his rights against the obligor directly.

Ordinary rights, including future rights, are freely assignable unless the assignment would materially change the duty of the obligor, materially increase the burden or risk imposed upon the obligor by his contract, impair the obligor's chance of obtaining return performance, or materially reduce the value of the return performance to the obligor, and unless the law restricts the assignability of the specific right involved. See Restatement (Second) Contracts § 317(2)(a) (1982). In Maine, the transfer of a future right to *proceeds* from pending litigation has been recognized as a valid and enforceable equitable assignment. We reaffirm these well established principles.

Relying primarily upon the Federal District Court's decision in *Shiro*, 174 F.Supp. 495, a bankruptcy case involving the trustee's power to avoid a preferential transfer by assignment, *Irace* and *Lowry* contend that Jones's June 14, 1988 letter is invalid and unenforceable as an assignment because it fails to manifest Jones's intent to permanently relinquish all control over the assigned funds and does nothing more than request payment from a specific fund.

We disagree. The June 14, 1988 letter gives no indication that Jones attempted to retain any control over the funds he assigned to Dr. Herzog. Taken in context, the use of the word "request" did not give the court reason to question Jones's intent to complete the assignment and, although no specific amount was stated, the parties do not dispute that the services provided by Dr. Herzog and the amounts that he charged for those services were reasonable and necessary to the treatment of the shoulder injury referred to in the June 14 letter.

Irace and Lowry had adequate funds to satisfy all of Jones's creditors, including Dr. Herzog, with funds left over for disbursement to Jones himself. Thus, this case simply does not present a situation analogous to Shiro because Dr. Herzog was given preference over Jones's other creditors by operation of the assignment. Given that Irace and Lowry do not dispute that they had ample notice of the assignment, the court's finding on the validity of the assignment is fully supported by the evidence and will not be disturbed on appeal.

Ethical Obligations

[The Court rejects the defendants' claim that the assignment, if enforceable, would interfere with their ethical obligation to honor their client's instructions in disbursing funds.]

Judgment affirmed.

Notes and Questions

1. The case demonstrates the power of assignment and its impact not just on the obligor (here, Irace and Lowry) but also on the assignor (Jones). Once the assignor assigns the contract, the obligor must perform according to the assignment. Not doing so is a breach of the contract. Moreover, after a valid assignment, the parties to the contract cannot discharge or modify the assigned obligation. *See also* UCC § 9-406(a), (b).
2. In a footnote, the court mentions that Jones only assigned his right for the proceeds and not the tort claim itself. This likely means that he was still the plaintiff in the tort lawsuit and was able to make decisions concerning that case. This distinction is important because assignments of tort claims raise public policy concerns. Courts are divided as to whether a tort claim can be assigned, although some of the courts that prohibit an assignment of the tort claim allow an assignment of the proceeds. What concerns do an assignment of tort claims raise? To what degree does the assignment of the proceeds from a tort claim avoid or mitigate those concerns?
3. As is the case with intended third-party beneficiaries, an obligor can assert against the assignee almost any defense it has against the assignor under the contract that gave rise to the right being assigned, including all formation defenses, impossibility, frustration of purpose, and the failure of express and implied conditions.

As for rights that originated outside of that contract, the obligor can only set off rights against the assignee itself or rights that accrued against the assignor prior to receiving notice of the assignment. If, for example, Jones owed his lawyers \$500 when they received notice of the assignment, and incurred \$600 additional debt afterward, then (putting aside possible ethical limitations that attorneys might be subject to) the lawyers would have been allowed to set off the first \$500 (but not the additional \$600) against the \$20,000 payment to Herzog. Moreover, if Herzog owed them \$800 from an unrelated transaction (for example, he did not pay for a laptop they sold him), the lawyers would have been entitled to set off that amount as well.

4. When an assignee cannot enforce its rights against the obligor because the obligor raised a valid defense, it might have recourse against the assignor. Unless the contract or the circumstances provide otherwise, courts assume that an assignment includes a warranty that the right assigned is valid and enforceable.

Note: From Assignment to Negotiable Instrument

We saw that using an assignment the assignor transfers contractual rights to the assignee. That right, however, is subject to the same imperfections that existed before the assignment, and the obligor can raise a host of defenses against it. Only if the obligor has entered into an agreement with the obligee not to assert defenses against an assignee, the assignee takes the assignment free of those defenses. *See* UCC § 9-403(b).

By contrast, a holder of a negotiable instrument (for example, a check) may obtain a right superior to that of the one from whom it received the instrument. One right-holder does not simply “step into the shoes” of the other. This extraordinary legal effect given to negotiable instruments is now set forth in Article 3 of the UCC. The writing must meet certain formal requirements, UCC § 3-104, and must be transferred in prescribed ways, UCC § 3-202. But then, if those to whom the instrument was transferred qualify as “holders in due course,” UCC § 3-304, they take the instrument free of most defenses, UCC § 3-305. For example, if Audrey transfers Brnadon’s check to Cathy, Cathy might be able to cash it even if Brnadon has a valid defense against Audrey (e.g., if Audrey materially breached the contract that gave rise to Brnadon’s promise to pay with that check).

The emergence of negotiable instruments has been indispensable in facilitating many types of modern commercial transactions. It is an important part of “the triumph of the good faith

purchaser,” characterized as “one of the most dramatic episodes in our legal history.” Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057 (1954). Overcoming the obligor’s defenses creates extremely valuable uniformity and saves parties along the stream of commerce significant transaction costs.

As you can surely imagine, a full analysis of the value, risks, and the legal questions that entail negotiable instruments is beyond the scope of a course on contract law.