THE LAW OF CONTRACTS

SUPPLEMENTAL READINGS

Class 08

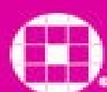
Professor Robert T. Farley, JD/LLM

EXAMPLES & EXPLANATIONS

Contracts

Seventh Edition

Brian A. Blum



Wolters Kluwer

CHAPTER 19

Assignment, Delegation, and Third-Party Beneficiaries

§19.1 INTRODUCTION

Throughout this book, it is emphasized that contract is a consensual relationship created by agreement between the parties. In dealing with the enforcement of contracts, it has been taken for granted that contractual rights and duties arise only between the parties and that the power of enforcement resides in each against the other. In the great majority of contracts, this assumption is accurate. A person who is not a party to a contract cannot be bound by it and acquires no rights under it. However, this chapter deals with two situations in which this rule is qualified. Although these situations have in common the fact that a nonparty to the contract obtains the right to enforce a promise under it, they are otherwise quite distinct and are based on very different premises.

In the first situation, the parties to the contract expressly or impliedly agree, at the time of making it, that the performance of one of them will be rendered to or for the benefit of a person who is not a party to the contract, and that the nonparty will have the right to enforce that commitment. The

creation of the third-party rights is contemplated by the parties and occurs at the time of contract formation.

In the second situation, there is no conferral of rights on a nonparty at the time of contracting. Rather, after the contract is formed, one of the parties transfers his contractual rights or obligations, or both, to a third party. The transfer of contractual rights is called an assignment, and the transfer of duties is called a delegation. The right to assign contractual rights is based on the concept that a party's right to performance under the contract is an asset belonging to that party. As a property interest, it is generally capable (with exceptions to be noted later) of being transferred (assigned) by sale, donation, or other means of disposition. When a party assigns rights under a contract (thereby becoming the assignor), ownership of those rights passes to the recipient (assignee) who is substituted for the assignor as the person entitled to performance. Unlike assignment, the delegation of contractual duties is not based on any concept of ownership—one cannot own a duty. Nevertheless, it is also generally permissible provided that it does not impair the reasonable expectations of the party to whom the performance is due.

§19.2 THIRD-PARTY BENEFICIARIES

§19.2.1 The Distinction Between Intended and Incidental Beneficiaries

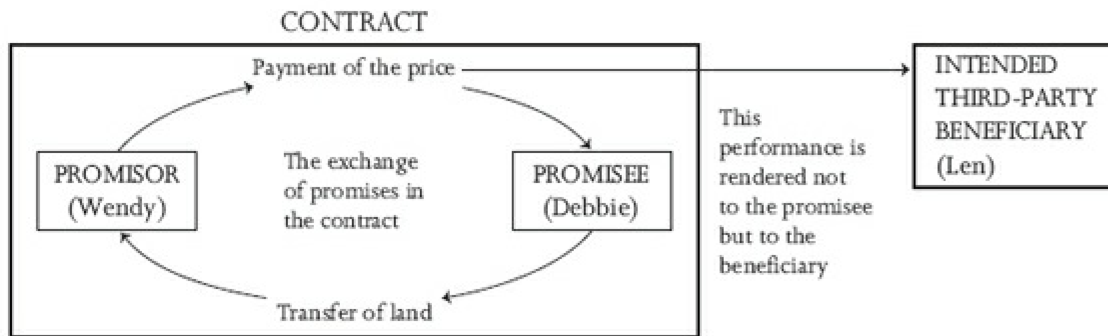
Contracts routinely benefit people who are not parties. For example, neighbors are benefited by the aesthetic enjoyment of a well-groomed yard, resulting from a landscape maintenance contract between a homeowner and a gardener; nearby hotels are benefited by a contract between a property owner and builder to erect a new convention center. In fact, in a complex interactive economy, vast numbers of contracts between strangers allow people to enjoy facilities and services that would otherwise not be available. However, even though these bystanders may derive some advantage from the contract, and even have an important stake in its performance, they have no legal rights under the contract. Therefore, if the landscaper or builder breaches the contract by failing to perform, the adjacent property owners have no cause of action to enforce it. They are known as incidental beneficiaries—the benefit they anticipated was purely a fortuitous and incidental result of a transaction between others. The contracting parties may have been pleased, indifferent,

or resentful to see someone else derive benefits from their contract, but they did not make the contract for the purpose of conferring those benefits.

However, in contrast to these more commonplace situations in which the positive effects of the contract on a third party occur merely by happenstance, a contract may be entered for the deliberate purpose of bestowing a benefit—and more importantly, a power to enforce that benefit—on a third party. That is, a contract is properly described as for the benefit of a third party only if it manifests the intent to give a benefit to a third party, directly enforceable by that third party against the contracting party who undertakes to perform it. It is the creation of this directly enforceable right that is the hallmark of a contract for the benefit of a third party. For example, Debbie Tor owes $20,000 to Len Der. Debbie enters into a contract with Wendy Vendee under which Debbie sells a plot of land to Wendy for $20,000, and the contract stipulates that Wendy will pay the $20,000 to Len. Debbie's purpose, of course, is to have the proceeds of the property transmitted directly to Len to settle the debt. In this case, the payment to Len does not occur as a fortuitous result of the contract but is specifically called for by it. Len's benefit is not merely incidental, but is clearly contemplated and deliberately conferred. If it is expressed or can be reasonably inferred that the parties, in contracting for the performance to be rendered to Len, also intended to give Len the right to enforce Wendy's promise of performance directly and independently of Debbie, Len acquires the status of intended beneficiary.

When a contract is intended to confer a benefit on and create enforcement rights in a third-party beneficiary, the contracting party who is to render the performance to the beneficiary (in the example above, Wendy) is usually referred to as the promisor, and the contracting party whose right to performance has been conferred on the beneficiary (in the above example, Debbie) is usually called the promisee. This nomenclature could be confusing because in a bilateral contract the terms "promisor" and "promisee" are relative—each party is both a promisor with regard to his own performance and a promisee with regard to the performance promised by the other. However, as we look at the contracting parties from the perspective of the third-party beneficiary, "promisor" means the party who has committed to perform in favor of the beneficiary. Diagram 19A illustrates the basic relationship and the terminology.

Diagram 19A



If the parties intend to confer the status of intended beneficiary on someone, that person is likely to be specifically named or identified in the contract. If this is not so, the strong inference is that the benefit is merely incidental. However, this conclusion is not inevitable. Intent to benefit is a matter of interpretation. Provided that the beneficiary will be identifiable when the time for performance falls due, it could be apparent that the parties did intend to create rights in his favor, despite the lack of specific identification at the time of contracting.

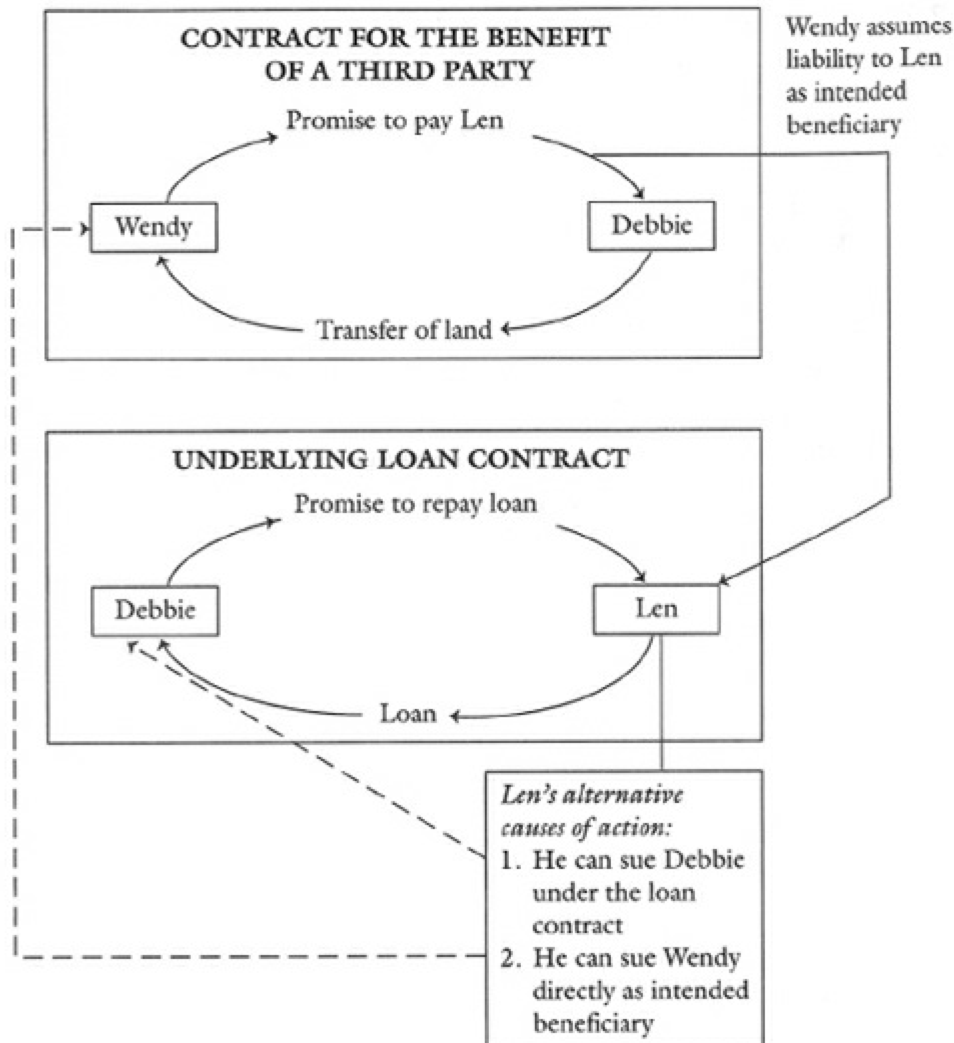
§19.2.2 The Essence of Intended Beneficiary Status: The Right of Independent Enforcement

As indicated above, when a contract confers the status of intended beneficiary on a third party, this does not mean only that performance must be rendered to or for the third party's benefit. It also means, as Restatement, Second, §304 provides, that the contract manifests the intent to grant the beneficiary an independent cause of action to enforce the promise. The grant of this enforcement right in the beneficiary is the central point of the third-party beneficiary doctrine and the distinguishing feature of a contract for the benefit of a third party. The beneficiary's direct cause of action against the promisor can be of great importance in making the benefit meaningful. He can pursue the right to performance on his own and does not have to depend on the promisee to take enforcement action.

In the above example, if Len had no independent right of enforcement, he would not be able to sue Wendy, the promisor, if she failed to perform in his favor as promised. Debbie, the promisee, would be the only person who could sue Wendy for the payment, and Len's only claim would be against Debbie, his debtor under the loan contract. However, as an intended

beneficiary, Len can sue Wendy directly if she fails to pay. He has this right of direct enforcement in addition to his right to sue Debbie under the loan contract, so he has two people against whom he can seek recourse for the unpaid loan. (Of course, he can obtain only a single satisfaction of his claim, so one of them is released from liability to him to the extent that the other pays.) This is represented in Diagram 19B.

Diagram 19B



English common law did not recognize such a direct cause of action in the beneficiary unless the beneficiary could establish either that the promisee was acting as his agent or that the contract created a trust. However, in the mid-nineteenth century, the concept of direct enforcement by the beneficiary

developed in American law. *Lawrence v. Fox*, 20 N.Y. 268 (1859), is recognized as the groundbreaking case. A man named Holly lent $300 to Fox. Holly was indebted to Lawrence for the same amount, and so Holly and Fox agreed that Fox would repay the loan amount to Lawrence. When he failed to pay, Lawrence sued Fox, who defended the suit on the basis that Lawrence had no standing to sue because he was not a party to the contract—there was no privity between them. The court rejected this defense and articulated the principle that even where no agency or trust is established, the parties to a contract do have the power to create rights enforceable by a person who is not a party to a contract, and that person can sue the promisor to enforce the performance undertaken to the promisee for his benefit.

§19.2.3 The Intent to Confer an Independent Right of Enforcement

The recognition of enforcement rights in a nonparty may seem like a radical departure from the general concept of contract as a private consensual arrangement that creates rights only between those who have bound themselves to each other. However, the third-party beneficiary doctrine is consistent with that concept because the third party only acquires the right to enforce the benefit if it is apparent that the parties intended to give him that right—they have elected to create the beneficiary status as part of their agreement. As stressed already, it is not enough that the contracting parties expect or intend to benefit the third party, or even that the contract calls for performance to be rendered to the third party. It must also manifest the intention to give the third party the right to enforce the performance if it is not rendered. This is reflected in Restatement, Second, §302(1), which recognizes a "right to performance" (which means the right to enforce the performance) in the beneficiary only when it is appropriate to effectuate the intention of the parties.

Like all other contract terms, the intent to establish third-party enforcement rights is a matter of interpretation. If the contract expressly articulates the intent to confer or not to confer enforcement rights on a third party, the resolution of this question is relatively easy. If, as commonly happens, the contract does not clearly articulate the parties' intent, it must be gleaned by the normal process of interpreting the factual evidence of intent, and if that is inconclusive, by construing what the parties must reasonably have intended. As usual, an objective test is used, and it is the mutual intent

of the parties that is relevant, not the uncommunicated subjective intent of just one of them. It is not enough that the promisee intends to confer the benefit on the beneficiary. The promisor must also have reasonably have understood that she was agreeing to assume an obligation to the beneficiary.

A few cases illustrate the process of interpretation where the contract does not expressly designate a third party as an intended beneficiary. *Martis v. Grinnell Mutual Reinsurance Company*, 905 N.E.2d 920 (Ill. App. 2009), involved a contract between Grinnell, an insurance company, and an employer whose workers were insured against injury. The policy stated that the insurer was "directly and primarily liable to any person entitled to benefits payable by this insurance." The plaintiff was a chiropractor who had provided medical services to one of the insured employees. He filed a class action suit against Grinnell, claiming that it had breached the contract with the employer by improperly applying a discount to the payments made to medical providers. He asserted standing to sue Grinnell on the basis that medical providers were intended beneficiaries of the insurance contract between Grinnell and the employer. The court disagreed and held that the plaintiff had not discharged the burden of showing that medical providers were intended beneficiaries of the policy. The policy language, "any person entitled to benefits," referred to the employees of the insured employer, and showed no intent to confer an independent right of action on providers, who were merely incidental beneficiaries.

In *Jackson v. American Plaza Corp.*, 2009 WL 1158829 (S.D.N.Y. 2009), the plaintiffs, who advertised room rentals on Craigslist, sued the defendant, a competitor who also advertised on the list, claiming that the defendant had violated the standard terms of use in its clickwrap agreement with Craigslist by making multiple postings of repetitive advertisements. The plaintiffs claimed that the multiple postings harmed their business, and they sought to enjoin this practice on the theory that they were intended beneficiaries of the terms of use. The court held that they were not. The terms of use did not expressly confer rights of enforcement on other list users. They made it clear that the consequence of making repetitive postings would be that Craigslist would block the postings, and that the only recourse available to a dissatisfied user was to discontinue use of the list. The court found that, interpreted as a whole, the sole purpose of the prohibition on repetitive advertisements was to prevent the overburdening of Craigslist's infrastructure.

By contrast, the court allowed the plaintiff to pursue a claim as an intended beneficiary in *Cianciotto v. Hospice Care Network*, 32 Misc. 3d 916 (N.Y. Dist. 2011). The plaintiff's terminally ill father had entered into a contract with the hospice under which the hospice would provide care for him for six months. The hospice ended the services after only a few weeks. After the father died, the plaintiff sued the hospice for breach of contract, claiming mental distress damages. The hospice sought summary judgment on the basis that it had no contract with the plaintiff. The court refused to grant the motion because it found that the plaintiff had a viable claim as an intended beneficiary of the contract between the hospice and her father. The contract recognized her by name as her father's primary caregiver and contemplated that the hospice care would relieve her of the responsibility to care for him in his declining condition. (The court also recognized that this may be a type of contract in which mental distress damages are recoverable, because its purpose was to relieve the plaintiff of mental anguish.)[1]

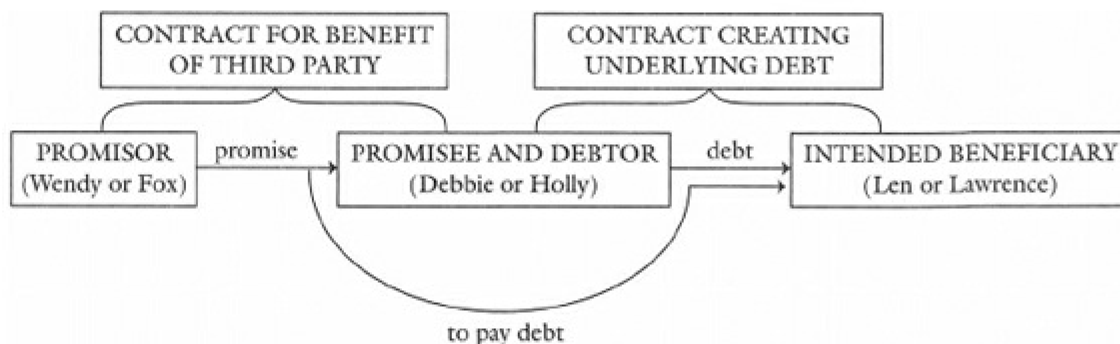
§19.2.4 The Relevance of the Relationship Between the Promisee and the Beneficiary: Creditor and Donee Beneficiaries

As just mentioned, Restatement, Second, §302(1) sets forth a broad standard to guide the determination of whether a nonparty to the contract should be treated as an intended beneficiary: The recognition of the beneficiary's right to enforce performance must be appropriate to give effect to the parties' intent. The intent to confer the benefit is the central criterion and the focus of the inquiry. This is possibly all that needed to be said. However, motivated by a long tradition that it wishes neither to follow nor to abandon, §302(1) goes on to suggest what appears to be a second requirement: There must also be some relationship between the promisee and the beneficiary from which it can be inferred that the parties had the beneficiary's interests in mind when entering the contract. Although this seems to be set out as a prerequisite in addition to intent, it is really just a subset of the general inquiry into what the parties intended. If a relationship between the promisee and beneficiary can be identified to explain the motivation for conferring the benefit, the conclusion of intent to benefit is reinforced.

This bipartite inquiry originates from the established conception, reflected in the first Restatement, that a beneficiary can be regarded as intended, rather than incidental, only if one of two conditions is satisfied.

Either the beneficiary must be a creditor of the promisee, or it must be clear that the promisee intended to make a gift of the benefit to the beneficiary. The situation involving a creditor beneficiary has already been illustrated by both *Lawrence v. Fox* and our example involving Debbie, who made a contract with Wendy under which Wendy would render performance to Debbie's creditor, Len. This set of relationships is represented in Diagram 19C.

Diagram 19C

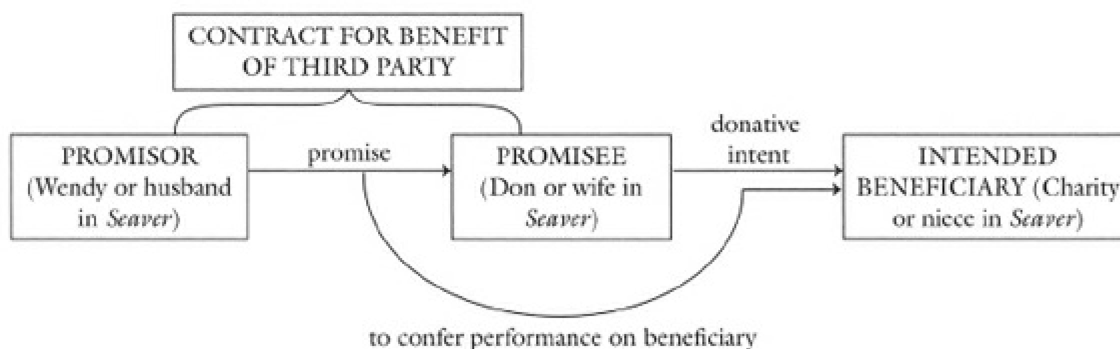


By contrast, if the promisee owes no debt to the third party, but intends to make a gift of the performance, the third party is a donee beneficiary. Although *Lawrence v. Fox* expressly dealt only with a creditor beneficiary, its basic principle was broad enough to be extended to cases in which the promisee was not indebted to the beneficiary. As a result, later cases recognized that a person could qualify as an intended beneficiary when the purpose of conferring the benefit was not to pay any debt, but to give her a gift. *Seaver v. Ransom*, 120 N.E. 639 (N.Y. 1918), is the most famous of these cases. A dying woman intended to bequeath a house to her niece. Upon being presented with a will that omitted this bequest, she agreed to sign on the strength of a promise by her husband, the residual legatee, that he would cure the omission by making provision in his own will for a bequest to the niece of equivalent value. When the husband eventually died, it was discovered that he had not made the bequest as he had promised his late wife. The niece sued his estate. The trial court gave judgment in favor of the niece on the theory that her uncle had held the house from his wife in constructive trust. Although it affirmed the judgment in favor of the niece, the court of appeals rejected the trust theory. Instead, basing its decision on *Lawrence* and subsequent cases, it found that there was no reason in principle to confine the

third-party beneficiary doctrine to cases involving creditor beneficiaries. The uncle and aunt had made a contract under which the niece was an intended beneficiary, and she could enforce the promise against the uncle's estate.

As another illustration, say that Don Nation entered into a contract with Wendy Vendee under which he sold a plot of land to her for $20,000. His purpose in selling the land was not to pay a debt, as in the example involving Debbie, but to realize funds to be donated to his niece, Charity. Don therefore stipulates in the contract with Wendy that the sale price be paid directly to Charity. (Although the fact that Charity gave no consideration to Don for the benefit would preclude her from enforcing the promise against Don, the lack of consideration from Charity does not bar her suit against Wendy. The contract being enforced by Charity as an intended beneficiary is that between Don and Wendy, and consideration was exchanged between the parties to that contract.) This set of relationships is shown in Diagram 19D.

Diagram 19D



Section 302(1) attempts to move away from the creditor-donee dichotomy, which it finds too rigid and restrictive. However, it recognizes that the distinction is well ingrained in the caselaw and cannot be ignored. It therefore acknowledges the distinction but alters it to make it more flexible. Many courts have followed its lead. Section 302(1) identifies two types of situations in which it recognizes a relationship sufficient to bolster the conclusion that the beneficiary was intended: The first, set out in §302(1)(a), approximates the concept of creditor beneficiary by covering cases in which performance of the promise will satisfy a monetary obligation due by the promisee to the beneficiary. This is somewhat narrower than the original category, which included not only monetary obligations but also situations in which performance of the promise would satisfy an actual, supposed, or

asserted duty of the promisee to the beneficiary. The narrowing of this category is more than compensated for by the widening of the second. The second, set out in §302(1)(b) is based on, but more expansive than, the older category of donee beneficiaries. It encompasses not only situations in which gratuitous motives are apparent but any case in which the circumstances indicate that the promisee intends to give the benefit of performance to the beneficiary. As just noted, this would include cases in which there is some supposed or asserted duty that is not clear enough to fall into §302(1)(a) as an actual liquidated monetary obligation. This sounds very vague and open-ended, but that is what is intended. The idea is to let courts decide case by case, with a strong focus on the parties' intent, as bolstered by some relationship between the promisee and the beneficiary that plausibly points to a motive for conferring the benefit.

§19.2.5 Vesting of the Benefit and the Parties' Power to Modify or Terminate It

In the same way as parties have the power to make a contract, they have the power to modify or terminate it by subsequent agreement. The alteration or discharge of a contract, like its creation, is dependent on the parties' assent.[2] It would therefore seem to follow that as the parties to the contract have created the beneficiary's rights, they could agree to change them or take them away entirely. However, if they had the unrestricted power to do this, the status of intended beneficiary would be very uncertain and unreliable. To protect the beneficiary's actual or potential reliance on the contract, the rule has been developed that at some point after the contract is made, the benefit vests in the beneficiary—it becomes irrevocably settled on her so that it cannot be changed or withdrawn by the contracting parties without her consent. If the parties do agree to modify or discharge the contract after the benefit has vested, this agreement binds the parties between themselves, but it binds only them. It does not affect the rights of the beneficiary, who can enforce the performance as it vested under the original agreement. It is therefore possible that the promisee could agree to give up her own rights of enforcement or to change them so that they are less extensive than those that have vested in the beneficiary.

Over the years, different courts have adopted various approaches to the question of when the benefit vests. Some have treated it as vesting

immediately upon formation of the contract, but others have required some manifestation of acceptance or some act of reliance on it by the beneficiary. The original Restatement had different rules for vesting depending on whether the beneficiary was a donee or a creditor. Restatement, Second, §311(3) makes no such distinction. It seeks to clarify and standardize the rule for vesting, irrespective of the nature of the underlying relationship between the promisee and the beneficiary. It provides that the benefit vests in the beneficiary when she manifests assent to it at the request of one of the parties, or she sues on it, or she materially changes her position by acting in justifiable reliance on it. This formulation clearly shows the analogy between vesting and the formation of other promissory obligations. Its basis is quite akin to that for offer and acceptance or promissory estoppel: The right vests in the beneficiary either when she "accepts" it by manifesting assent to it, or when she has detrimentally relied on it. Once that has occurred, the contracting parties are committed to the conferral of rights, and the beneficiary's independent cause of action on the promise is secure.

This rule is subject to a qualification: As creators of the benefit, the contracting parties can confer it subject to whatever limitations and conditions they see fit. By so stipulating in the contract, they can retain the power to modify it or take it away even after it has vested in the beneficiary. These limitations will inhere in the right created in favor of the beneficiary, and it will vest subject to them. However, the parties must clearly reserve the power to alter the rights after vesting. If they do not, their power to alter the rights, as against the beneficiary, terminates as soon as the benefit vests.

§19.2.6 The Promisee's Parallel Rights of Enforcement Against the Promisor

Notwithstanding the conferral and vesting of rights in the beneficiary, the promisee continues to be a party to the contract. As such, except to the extent that the beneficiary has enforced and obtained satisfaction of the performance, the promisee has the right to enforce the promise just as she would have had in an ordinary bilateral contract. Restatement, Second, §305(1) reflects this by stating that the promisor has a duty of performance to the promisee, even though he has a similar duty to the beneficiary. This does not mean that the promisor has to perform the obligation twice. The promisee's right against the promisor is discharged to the extent that the

promisor performs in favor of the beneficiary. If full performance is not rendered to the beneficiary, the promisee may enforce the obligation to perform any remaining balance.

The nature of the relief available to the promisee depends on the circumstances. When a claim for damages is not an adequate remedy, she may request specific performance—an order compelling the promisor to render the performance to the beneficiary. Alternatively, the promisee may have a claim for damages based on her contractual expectation. This will at least consist of her direct damages, measured by the loss in value of the promised performance. In addition, if the failure to perform results in a foreseeable and unavoidable increase in the promisee's liability to the beneficiary or other consequential loss, consequential damages may also be claimed.

§19.2.7 The Promisor's Ability to Raise Defenses Against the Beneficiary

The beneficiary's rights derive from the contract, so it stands to reason that they are limited by any defense arising out of the contract. Therefore, the basic rule, as reflected in Restatement, Second, §309, is that unless the contract makes it clear that it confers rights on the beneficiary free of defenses, the beneficiary's rights are subject to any limitations inherent in the contract. The promisor may raise against the beneficiary any defense that would have been available against the promisee, arising out of a defect in the formation of the contract (such as invalidity due to lack of consideration, voidability on grounds of fraud, duress or some other bargaining defect, or unenforceability for failure to comply with the statute of frauds); or based on the promisee's breach of contract; or arising out of post-formation occurrences that affect the very basis of the contract, such as supervening impracticability and the nonoccurrence of a condition. (The beneficiary's position is very much like that of an assignee, discussed in section 19.3.3.)

Although a wrongful act of the promisee (such as breach or fraud) can be raised by the promisor as a defense against the beneficiary, it does not impose any liability on the beneficiary. He does not, by accepting the benefit, assume any responsibility for proper behavior or performance by the promisee. Any recourse that the promisor has must be pursued against the promisee.

Unless the contract expresses a contrary intent, the promisor cannot raise

against the beneficiary any defense that is purely personal against the promisee, such as a defense that the promisee owes money to the promisor in another transaction. Similarly, as we saw in section 19.2.5, if the promisee and promisor make an agreement to modify or discharge the performance after vesting, this agreement would be a defense to enforcement by the promisee, but it would not avail against the beneficiary.

§19.2.8 The Beneficiary's Rights Against the Promisee in the Event of the Promisor's Nonperformance

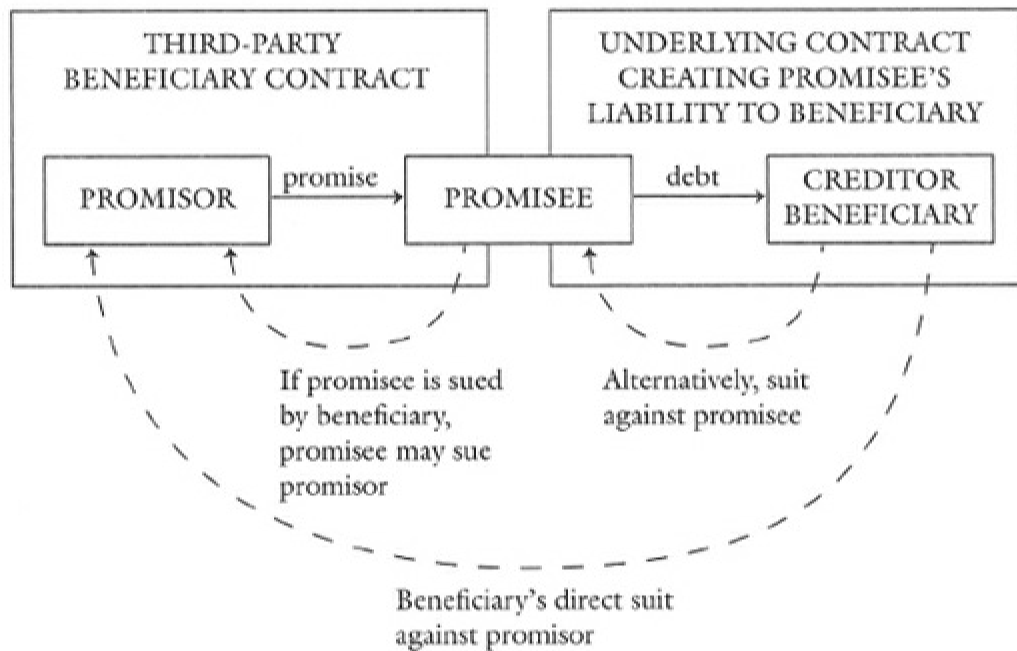
As has been stated already, once the benefit has vested in the beneficiary, he has a direct claim against the promisor and may proceed to enforce it if the promisor fails to perform. However, it may occur that the beneficiary is unsuccessful in obtaining satisfaction of his claim against the promisor either because the promisor has no money or assets to satisfy the claim, or because she is able to raise a defense against the beneficiary. When that happens, the question is whether the beneficiary may then proceed against the promisee. The answer depends on whether or not the conferring of the benefit was based on some duty or obligation owed by the promisee to the beneficiary. That is (using the traditional terminology), the beneficiary would qualify as a creditor beneficiary rather than a donee beneficiary.

If the beneficiary is a donee, or has otherwise not given consideration to the promisee, he has no enforceable claim against the promisee in the event that he is unable to recover from the promisor. However, if the beneficiary is a creditor of the promisee, he may, upon being unsuccessful in pursuing his claim against the promisor, proceed against the promisee to enforce the promisee's debt.

Some courts have not allowed the creditor beneficiary to sue the promisee after unsuccessfully trying to enforce rights against the promisor. They have held that once the beneficiary elects to proceed against the promisor, the right of action against the promisor is substituted for and eliminates the cause of action on the original debt due by the promisee. (This is called novation.) However, the more common contemporary view, as expressed in Restatement, Second, §310, is that the beneficiary surrenders no rights against the promisee by seeking to enforce the benefit against the promisor. Instead, the promisee becomes a surety for the promisor, so that to the extent that the promisor fails to perform, the promisee remains liable for

the outstanding amount of her undischarged debt to the beneficiary. (And, of course, the promisee may then attempt to recover from the promisor, based on the promisor's breach of her contract with the promisee.) This is shown in Diagram 19E.

Diagram 19E



§19.2.9 Citizens' Claims as Intended Beneficiaries of Government Contracts

The government represents the public. In a broad sense, it can therefore be said that whenever the government enters a contract, it has the intention of conferring a benefit on the citizenry at large, or on a group of citizens whose interests are furthered by the contract. However, this does not mean that an individual citizen can sue to enforce the performance promised to the government. As with other contracts that result in a benefit to a nonparty, the crucial question is not simply whether there was an intent to provide the benefit, but whether there was an intent to create an independent right of enforcement in the nonparty. Therefore, as Restatement, Second, §313(1) makes clear, government contracts are to be treated the same as contracts by private parties in deciding whether a third party was an intended beneficiary:

The terms of the contract must be interpreted in context to determine if it manifests the intent to confer a direct cause of action on the beneficiary. In the case of government contracts, the context includes any statute, regulation, or ordinance that authorizes the transaction and that may provide for or preclude a citizen's right of enforcement.

Although a government contract is generally subject to the same analysis as a private contract to determine intent to confer a right of enforcement on beneficiaries, there is a presumption that the government does not usually intend to confer a private right of enforcement on citizens, who are usually just incidental beneficiaries of government contracts. Courts distinguish between an intent to confer a benefit on the public, which is the broad underlying purpose of most government contracts, and the intent to allow members of the public to take private action to enforce the benefits provided in the contract, which would be quite an unusual situation. Therefore, to overcome the presumption that a private citizen is an incidental beneficiary, the citizen must demonstrate clear intent to grant a right of enforcement to citizens in the contract or in any legislation that authorizes the contract. Comment *a* to §313 reflects this approach by suggesting that in cases of doubt, the contract should be interpreted as not making citizens intended beneficiaries.

For example, in *Klamath Water Users Protective Assn. v. Patterson*, 204 F.3d 1206 (9th Cir. 1999), irrigators claimed that they were the intended beneficiaries of a government agency's contract with a power company for the management of a dam. They argued that they therefore had the independent right to enforce the power company's obligation to maintain flow levels required by the contract. Although the court recognized that one of the goals of the contract was to satisfy the government's duty to water users, it had other aims as well, and there was nothing in the contract to rebut the usual presumption that citizens who benefit from a government contract are incidental beneficiaries with no private enforcement rights. In *Edwards v. Aurora Loan Services, LLC*, 791 F. Supp. 2d 144 (D.C. 2011), the court stressed the strong general presumption that citizens are merely incidental beneficiaries of government contracts. To rebut that presumption, the language of the contract must demonstrate a clear intent to confer enforcement rights on citizens who benefit by the contract. The court held that the plaintiffs had not discharged this burden in relation to a contract entered into between the U.S. Treasury (through the agency of Fannie Mae)

and loan servicers, under which the loan servicers were obliged to modify the mortgages of homeowners in danger of foreclosure. In *Cooper v. Charter Communication Entertainments I, LLC,* 760 F.3d 103 (1st Cir. 2014), customers of Charter, a cable provider, sued it for failing to provide credits to customers for a period during which service was disrupted by a severe snowstorm. The plaintiffs based their suit on the theory that they were intended third-party beneficiaries of a licensing agreement between the city and Charter that required Charter to grant the credits and to pay the credited amount directly to customers. The court acknowledged that the contract was intended to benefit consumers of the cable service. However, the contract set out an enforcement process that provided only for enforcement by the city. This made it clear that the parties did not intend to confer a private right of enforcement on customers.

Cases in which the court found a citizen to be an intended beneficiary of a government contract are much rarer. *Zigas v. Superior Court*, 174 Cal. Rptr. 806 (Cal. App. 1981), is an example. The owner of an apartment building violated its contract with HUD (U.S. Department of Housing and Urban Development) to keep rentals within prescribed limits. The court decided that the sole purpose of both the contract and its authorizing legislation was to benefit tenants by keeping rents at a reasonable level and that the parties must reasonably have intended to give tenants an independent cause of action to enforce the rent limitation. The court reached this conclusion because the tenants, not the government, lost as a result of the breach, the statute provided no other procedure for tenants to seek redress, the tenants' suit did not interfere with any remedial or administrative proceedings prescribed by the statute, and there was nothing in the contract that indicated that the parties expected that the owner would be shielded from tenant suits.

§19.2.10 A Nonclient's Claim as an Intended Beneficiary of an Attorney-Client Contract

If an attorney acts incompetently in doing legal work for a client, the client has a cause of action against the attorney for malpractice. This claim could be based either in tort for negligence or in contract, for breach of the attorney's contractual duty to the client to perform the work in accordance with reasonable professional standards. In some situations, the attorney's incompetent performance could harm some third party who is not a client. If

that happens, it raises the question of whether the nonclient has any cause of action against the attorney.

As a general rule, a nonclient who is harmed by the attorney's negligence cannot sue the attorney in tort unless the nonclient can show that the attorney expressly or impliedly assumed a duty of care toward that nonclient, such as by making some commitment to the nonclient, falsely certifying untrue information, making a misrepresentation, or failing to disclose information that the attorney had a duty to disclose. Some courts, such as the court in *Blair v. Ing*, 21 P.3d 452 (Haw. 2001), have been willing to recognize a duty of care to a nonclient testamentary beneficiary, grounding a negligence claim, where the attorney acted incompletely in an estate planning matter, thereby causing loss to the beneficiary. However, in the absence of special circumstances, courts usually hold that an attorney's duty to act with reasonable competence runs only to his client, and gives no cause of action for malpractice by a nonclient who suffered economic loss as a result of the attorney's negligence in handling the client's affairs. This is based on the policy, as explained in *Guy v. Liederbach*, 459 A.2d 744 (Pa. 1983), and *Noble v. Bruce*, 349 Md. 730 (1998), that potential malpractice liability to a nonclient could distract an attorney from focusing on the client's best interests, could undermine the attorney's loyalty to his client, and could create a conflict of interest as the attorney tries to balance his duty to his client against the need to safeguard the nonclient's interests.

However, in some cases, nonclients have sued attorneys for malpractice, not on a tort theory but on the grounds that the nonclient was an intended beneficiary of the contract between the attorney and client. A nonclient could acquire a cause of action against an attorney as an intended beneficiary of the contract between the attorney and client, provided that it is clear that the attorney and client intended to confer an independent right of enforcement on the nonclient. For example, in *Hale v. Groce*, 744 P.2d 1289 (Or. 1987), an attorney breached his contract with his client by failing to draw the client's will as instructed. As a result, a legatee was deprived of a legacy that the client had intended for him. The court found that the legatee was an intended beneficiary of the contract between the client and the attorney and therefore had an independent cause of action against the attorney for the breach. Similarly, in *Guy*, the attorney had the named beneficiary of a will sign it as a witness, thereby voiding her legacy. Although the court noted that a legatee does not become a third-party beneficiary merely because she is named in the

will, it found that she was an intended beneficiary of the attorney-client contract because unless she was given a right to enforce it, there would be no one to hold the attorney accountable for his breach. The testator was dead and the estate had no incentive to sue. *Noble* took a less sympathetic approach to testamentary beneficiaries. It found no express or implied intent in the contract between the testators and their attorney to confer a direct right of enforcement on the beneficiaries, and would not imply such a right merely because they were the only persons with an incentive to enforce the contract. The court's reluctance to find a right of independent enforcement was motivated by its concern that ready recognition of third-party-beneficiary rights is just as harmful to the attorney-client relationship and raises the same policy concerns as allowing a nonclient to sue the attorney for malpractice. The policy issue was emphasized in *Macht v. Estate of Dobkin,* 19 Mass. L. Rptr. 318 (Mass. Super. 2005), in which the client died before the attorney had complied with her instructions to draft a new will that left her estate to the plaintiff. The court emphasized the need not to compromise the attorney's duty of undivided loyalty to the client, and cautioned that recognition of an independent right of enforcement in a nonclient could make it difficult for an attorney to focus on the client's interests while trying to avoid possible liability to the nonclient.

§19.3 ASSIGNMENT AND DELEGATION

§19.3.1 The Basic Concept and Terminology

Section 19.2 is concerned with cases in which the parties to a contract intend, at the time of entering it, to confer an enforceable benefit on someone who is not a party to the contract. Although assignment and delegation also involve the introduction of a third party into the contract, the circumstances under which that happens and the legal relationship that arises is very different from that of a third-party beneficiary. We are not here concerned with a contract in which, at the time of contracting, the parties intend to confer rights on a third party. Rather, we deal with a decision made by one of the parties, after the contract has been entered, to transfer his rights, or his duties, or both to a third party. Assignment and delegation are only possible once a contract has

been made and those rights and obligations have come into existence.[3] The well-established general rule, reflected in Restatement, Second, §317(2) and UCC §2.210(2), is that unless a contract specifically prohibits a party from transferring her rights acquired and duties assumed under it, or the nature of the contract is such that the transfer would impair the other party's reasonable expectations or would offend public policy, a party has the power to transfer contractual rights and obligations.

It is useful to begin with the terminology used to describe such a transfer and its participants: The transfer of rights is called an assignment, and the transfer of duties is a delegation. The person who assigns a contractual right is the obligee under the contract and becomes the assignor. The person to whom it is assigned is the assignee. The other party to the contract, whose duty is transferred to the assignee by the assignment, is referred to as the obligor. A person who delegates her contractual duty is the obligor under the contract and becomes the delegator of the duty. The person who assumes the duty is called the delegate. The other party to the contract, whose right to performance has been delegated, is called the obligee. The relationships are shown in Diagram 19F, in which Party 2 is the person who decides to assign her obligations or delegate her duties.

It is important to recognize that a contractual right is an asset of the obligee—an item of property with some value. Therefore, subject to some qualifications stated in section 19.3.3, the owner of a contractual right can transfer it like any other property—sell it, donate it, or use it as collateral. The law generally presumes that contract rights can be transferred, except where the contract or public policy precludes it. By contrast, contractual obligations are not property rights of the obligor. In addition, the transfer of those duties could have a more significant impact on the rights of the obligee. Therefore, the presumption of transferability is not as strong as it is with contractual rights, and the delegation of contract duties, although usually possible, is subject to greater restrictions than the assignment of rights. These restriction are set out in sections 19.3.6 and 19.3.7.

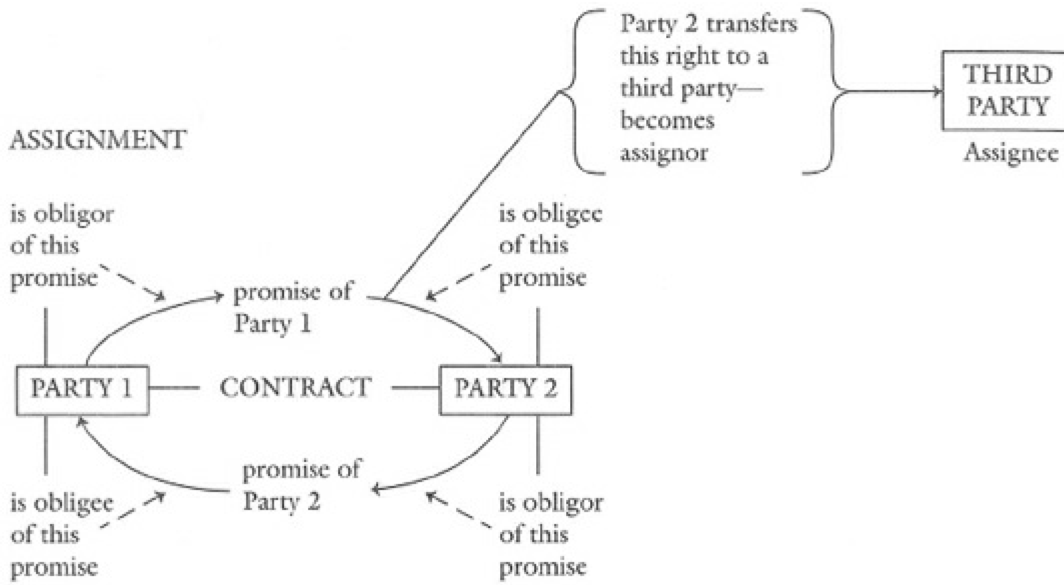
§19.3.2 The Nature of an Assignment

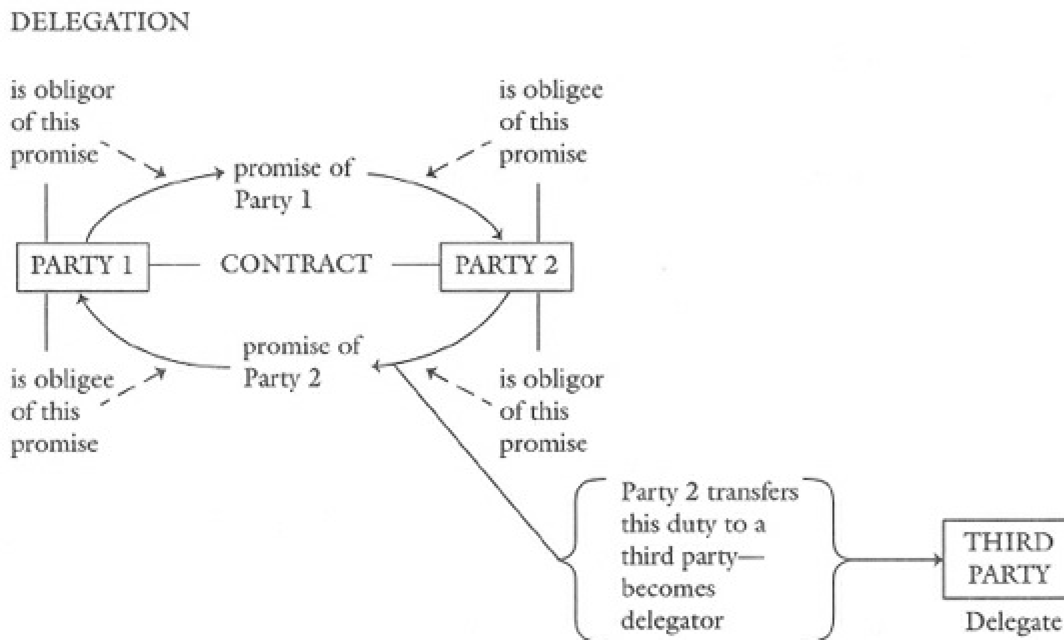
Although a right can be transferred without the consent of the rightholder (for example, where a judgment creditor executes on the right by the process of garnishment, or the rightholder becomes bankrupt and the right passes to the

trustee of his estate), we consider here only the voluntary assignment of rights. For our purposes, therefore, an assignment is a voluntary manifestation of intention by the holder of an existing right to make an immediate transfer of that right to another person. This definition breaks down into three essential components: First, the assignor must voluntarily manifest intent to assign the right; second, the right must be in existence at the time of assignment; and third, its transfer must take effect immediately.

In most cases, assignment is effected through a contract between the assignor and the assignee, but the transaction does not have to qualify as a contract. For example, a right may be transferred gratuitously so that the transfer is a gift rather than under a contract with consideration. Unless the contract creating the right forbids its assignment without the assent of the obligor, he need not be involved in the assignment.

Diagram 19F





There are some specialized types of assignment involving rights evidenced by commercial paper (such as negotiable instruments or documents) for which prescribed formalities must be satisfied. Apart from these transactions, which are beyond our scope, there are no particular

formalities needed for an assignment of ordinary contract rights, but the transaction may be subject to the statute of frauds.

As section 19.3.4 explains, the effect of an assignment is to extinguish the assignor's right to performance from the obligee and to transfer it to the assignee. For such a complete transfer to occur, the right must be in existence and transferred immediately. Furthermore, the transfer must be a complete relinquishment of the right by the assignor in favor of the assignee, so that the assignor retains no control over it and no power to revoke it. This absolute and unequivocal transfer is necessary for the protection of the obligor, who must be able to rely on the fact that performance in favor of the assignee will discharge her obligation.

A right comes into existence and can be assigned as soon as the contract creating it has been formed. The right can be conditional or not yet due at the time of assignment as long as it has been created already. For example, *Speelman v. Pascal*, 10 N.Y. 2d 313 (1961), involved the assignment of rights to a percentage of profits from the hit musical *My Fair Lady*. In 1952, Pascal acquired the rights from the estate of the late George Bernard Shaw to produce a musical based on his play *Pygmalion*. Before he even wrote the musical, he assigned a share of his profits to his secretary. He died soon thereafter, and the musical was not produced and staged until after his death. The court held the assignment to be effective. Although the musical was not yet in existence at the time of the assignment, the rights to future profits did exist and could be assigned. The assignee is bound by any conditions of performance and cannot enforce the right until such conditions have been satisfied and the maturity date of the right has arrived.

The assignment of a conditional or unmatured right must be distinguished from the transfer of a right that has not yet been created, but is expected to arise in the future. This does not qualify as an assignment. It may be a valid contract between the transferor and transferee, but it lacks the hallmark of an assignment—enforceability against the obligor. Similarly, a promise to assign an existing right in the future does not constitute an assignment. To constitute an assignment effective against the obligor, the transfer of the right must actually be accomplished, so that the transferee acquires it immediately.

§19.3.3 Restrictions on Assignment

As noted in section 19.3.1, the general approach of the law is that contract rights should be freely assignable because the obligee's right to performance under the contract is his property. It is property of a nature different from, say, his car or his house, in that it has no tangible physical existence. (It is called a "chose in action.") Nevertheless, it is his property all the same, and he should be able to dispose of it if he so desires. However, this right of disposition is subject to a qualification that arises from the nature of this particular kind of property. Unlike a car or house, a contract right represents a relationship with the obligor, who also has rights under it. Therefore, the obligee's power to deal with this property is tempered by the need to assure the obligor of her contractual expectation. Accordingly, the right cannot be assigned if doing so would violate the terms of the contract or otherwise materially impair the obligor's rights under it.

a. Contractual Restrictions on Assignment

An assignment cannot be validly made if the contract prohibits it. Because the law generally favors assignment, the contractual bar must be clearly expressed. Restatement, Second, §322 and UCC §2.210(3) call for a restrictive interpretation of contract provisions that appear to preclude assignment. Any doubt or ambiguity should be resolved in favor of transferability, and a clause that prohibits "assignment of the contract" should, if possible, be taken to forbid only the delegation of duties. Even if the contract does clearly prohibit assignment, this does not necessarily mean that an assignment would be invalid. Unless the language clearly deprives the obligee of the power to assign (for example, by stating that an assignment will be void), the assignment may be a breach of the contract (giving the obligor grounds for seeking a remedy for breach), but the transfer of rights is itself effective.

Instead of absolutely forbidding assignment, a contract may prohibit it without the consent of the party whose rights are being assigned. The general approach to a provision that requires permission to assign is reflected in *Julian v. Christopher*, 575 A.2d 735 (Md. 1990). Unless the contract makes it clear that the party has complete discretion to refuse permission, he is obliged to act reasonably in refusing it. This usually means, in effect, that he cannot legitimately refuse permission unless he can show that the assignment would be unduly burdensome or risky to him or would materially affect his contract

rights.

b. Restrictions on Assignment Resulting from the Nature of the Contract

Even if the contract does not, by its terms, forbid or restrict assignment, rights under the contract may not be assigned, in the absence of specific authorization in the contract, if assignment would materially change the obligor's duty, increase the burden or risk imposed by the contract, impair her prospects of getting return performance, or otherwise substantially reduce its value to her. This is recognized by Restatement, Second, §317(2) and UCC §2.210(2). Every assignment is likely to have some effect on the obligor's duty, even if that is nothing more than having to make a payment to someone other than the person she contracted with. The requirement of material impact prevents the obligor from resisting an assignment on the basis of some trivial change in her performance obligation.

To decide whether an assignment may have any of these materially adverse consequences, the contract must be interpreted in context. In many cases, especially when the performance in question is nothing more than the payment of money or the delivery of property, an assignment of rights is unlikely to have any negative impact on the obligor. It is a matter of indifference to her whether she pays or delivers to the original person with whom she contracted or to someone else designated by that person. However, in some contracts, the identity of the party who is to receive performance is important, and the obligor does have a stake in performing only for the original obligee. This may be true, for example, when performance is subject to a condition of satisfaction involving personal taste, or when the obligor reasonably expected to get some special advantage or credit by being associated with the obligee. (Cases like this may alternatively be viewed not as pure assignments, but as also involving a delegation of duty, on the ground that the obligee has a contractual duty to evaluate performance in good faith or to receive performance personally.)

c. Restrictions Based on Statute or Public Policy

Apart from any contractual barrier to assignment, the transfer of certain types of contract rights are contrary to the public interest, and therefore prohibited by statute or public policy. A common example is the statutory prohibition on

the assignment of a claim for wages, intended to protect workers from disposing of earnings in advance of receiving them. Another example is a claim against an attorney for malpractice. Many courts have held the assignment of a legal malpractice claim to be contrary to public policy because of the uniquely personal nature of the attorney-client relationship, which implicates confidentiality, loyalty, and trust. Some courts consider that public policy absolutely bars assignment of a malpractice claim, while others, such as *Gurski v. Rosenblum & Filan LLC*, 885 A.2d 163 (Conn. 2005), adopt a case-by-case approach that takes into account the nature of the breach and the circumstances of the assignment. In *Gurski*, the court held the assignment to be invalid because the assignee was the adversary of the client in the very action in which the malpractice was committed. That is, to settle the action in which the attorney had committed the malpractice, the client assigned his malpractice claim to the other party to the suit.

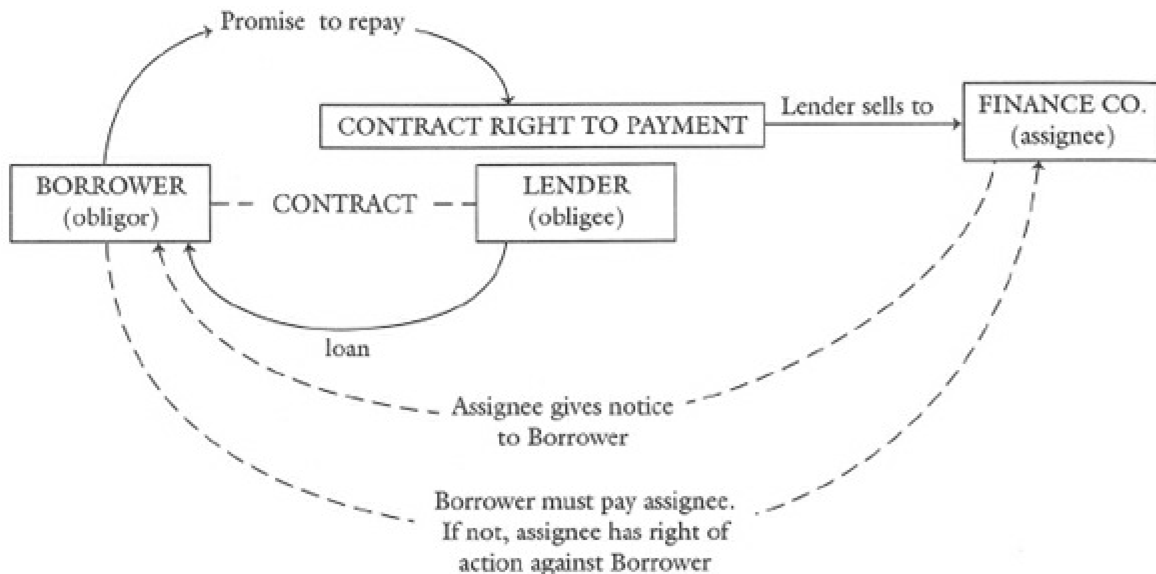
The assignment of claims that do not arise from contract is beyond our scope. However, it is worth noting that public policy forbids the assignment of certain kinds of noncontractual claims. For example, a tort claim for personal injury cannot be assigned because the trafficking in claims harms the public interest by enabling a litigious person to purchase and aggressively prosecute personal injury claims and by encouraging a tort victim to give up a potentially more valuable claim for advance payment.[4]

§19.3.4 The Effect of Assignment

The following simple example illustrates the basic effect and purpose of an assignment: Lender lends $10,000 to Borrower, who undertakes to repay the loan with interest in six months. After the loan is advanced, Lender no longer wishes to wait six months to get her money back. She therefore sells her contractual right of repayment to Finance Co. In this case, Lender is simply treating her contract right as a saleable asset and seeks to realize its economic worth.[5] Unless there is a term in the contract that forbids assignment, the transfer will surely be permissible, because it is not likely to have any materially adverse effect on Borrower's contractual burdens or expectations. Borrower has already received the performance of Lender's promise (advance of the loan funds) and his remaining duty is clear and not subject to any discretion or cooperation by the obligee. Borrower must simply pay a specified sum of money on a stated date. Lender falls out of the transaction

and Finance Co. is substituted as the obligee. When the time for repayment comes, Borrower will pay Finance Co. Of course, Borrower must be notified of the assignment so that he knows (or reasonably should know) this. If he is not, his payment to Lender will discharge his duty. This transaction is represented in Diagram 19G.

Diagram 19G



In this example, Lender assigned her contract right by sale, but sale is not the only reason for transferring rights. They may also be transferred for security—that is, used as collateral to secure a loan,[6] used to settle a preexisting debt or simply donated as a gift. Also, Lender assigned her entire right in the example, but she could have assigned just a portion of the performance, provided that a partial assignment would not materially burden Borrower.

After a valid assignment is made, the assignee substitutes for the assignor as the person to whom performance must be rendered. It therefore follows that although the obligor need not be a party to or assent to the assignment to make it effective, she must be notified of it so that she knows the person to whom performance is now due. There is no particular formality required for the notice, provided that it coherently indicates what right has been assigned, and to whom. The notice must be received by the obligor—that is, it must either come to her attention or be delivered so that she reasonably should be aware of it. Either the assignor or the assignee may give

the notice, but if it comes from the assignee, the obligor is entitled to adequate proof of the assignment.

If the obligor performs in favor of the assignor before receiving this notification, her obligation is discharged and she has no responsibility to the assignee. However, after receiving clear and adequate notification, the obligor, in effect, holds the performance in trust for the assignee and is obliged to ensure that he receives it. If the obligor disregards the assignment and performs for the assignor, she incurs personal liability to the assignee and will be obliged either to perform again or pay damages.[7] If the obligor pays the assignor after notice of assignment, he cannot defend against liability to the assignee merely on the ground that the assignor unilaterally countermanded his prior instruction to pay the assignee. For example, in *Herzog v. Irace*, 594 A.2d 1106 (Me. 1991), a client instructed his attorney to make payment of settlement proceeds to a creditor of the client—a doctor to whom the client owed fees for medical treatment. The client later changed his mind and told the attorney to pay the settlement to him, which the attorney did. When the doctor sued the attorney, the attorney argued that he had an ethical obligation to honor his client's instructions. The court disagreed. The attorney was aware that the client had assigned his payment right to the doctor, so the client no longer had a right to the settlement proceeds and could not validly revoke his instruction to pay the doctor.

§19.3.5 Defenses Against the Assignee

As a general rule, when rights are assigned, the assignee can get no greater right against the obligor than the assignor had. This is in accordance with the rather obvious proposition that when a person disposes of property, he cannot validly transfer more than what he owns. (Again, there are some important exceptions to this rule in the case of negotiable instruments and documents, but these are beyond our scope.) This means that the assignee takes the rights subject to any conditions and defenses that the obligor may have against the assignor arising out of the contract. For example, if the contract is avoidable by the obligor or unenforceable because of a defect in formation of the contract, or the obligor's duty is subject to an unsatisfied condition, or the assignor breached the contract, or the obligor's performance has become impracticable, these defenses can be raised against the assignee in the same way as they could have been against the assignor.

As in the case of a third-party beneficiary, the obligor may only use the assignor's breach defensively against the assignee. That is, the assignor's breach operates as a defense to the assignee's claim, and damages due to the obligor by the assignor may be offset against the assignee's claim. However, the assignee has no liability for the obligor's damages to the extent that they exceed the amount of the offset.

The obligor's right to assert defenses arising out of the contract is not cut off by the notice of assignment, so the defense is available against the assignee whether the basis for it (for example, the assignor's breach) arose before or after the obligor received notice. However, the notice does affect any claim of setoff that the obligor may have against the assignor, arising out of a different transaction. The rule is that the assignee's rights are subject to any such right of setoff that arose before a notice of assignment, but cannot be defeated by one that arose afterward. For example, say that Lender lent $10,000 to Borrower. In a completely separate contract, entered into a short while later, Borrower sold her car to Lender for $5,000. Lender took delivery of the car but failed to pay Borrower. When the time comes for Borrower to repay the loan, she has the right to deduct the $5,000 owed to her by Lender —she may set off the debt due to her under the car sale transaction against the debt that she owes Lender. If Lender has assigned his rights under the loan contract, Borrower's right of setoff may be asserted against the assignee provided that the right had not been assigned and notice of assignment received by her before the setoff right arose. However, if she received notice of assignment before the setoff right was created, the claim of setoff may not be raised against the assignee.

Unless the assignment indicates an intent to the contrary, the assignor impliedly warrants to the assignee that the rights assigned are valid and not subject to any defenses. Therefore, if the obligor successfully raises a defense against the assignee, the assignee usually has a cause of action against the assignor for breach of this warranty.

§19.3.6 Delegation

Restatement, Second, §318 and UCC §2.210(1) set out the basic principles of delegation: An obligor is entitled to delegate his contractual duties unless this violates the contract or public policy. As this suggests, the law's general approach to delegation is much like that toward assignment. A party should

be given the freedom to engage someone else to perform his contractual duties unless the contract prohibits this or the delegation otherwise impairs the obligee's reasonable expectations. However, delegation is not a transfer of a right, so it does not invoke the policy that protects a person's interest in dealing with her property as she desires. In addition, it stands to reason that while a mere assignment of rights will often make little difference to the other party's contractual expectations, a delegation of duty could quite likely have a direct impact on them. This is particularly true if the contract is founded on the personal attributes or skills of the obligor. For these reasons, delegation is subject to greater restriction than assignment.

Irrespective of whether the performance involves special skill or attributes, if the contract makes it clear that delegation is forbidden, this expressed intent will be given effect. A party is entitled, by so stipulating in the contract, to absolutely preclude the delegation of any duty owed to her. In the absence of a clear prohibition, delegation is allowed unless the obligee has a substantial interest in having the obligor himself perform or control the duty. This would be the case where the contract contemplates personal performance by the obligor or the obligor was chosen because of some particular attribute, skill, or talent relevant to performance. An impermissible delegation may in itself be a repudiation of the contract by the delegator, which may allow the obligee to declare advance breach and claim damages. If the obligee gives the delegator an opportunity to retract the delegation and he fails to do so in time and to render personal performance, this becomes a breach.

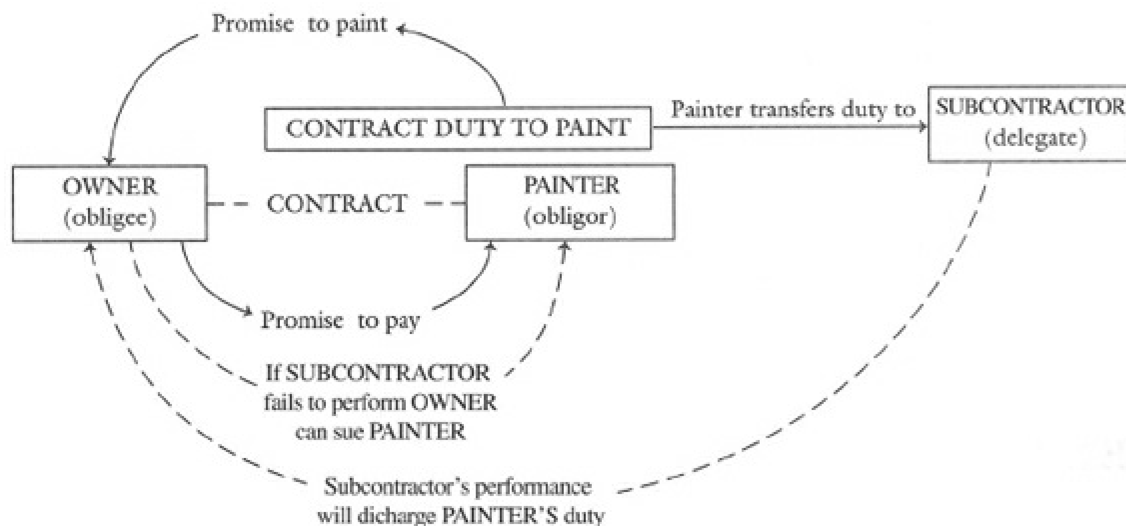
The effect of a permissible and effective delegation is that the delegator commits no breach of the contract by having his duty performed by the delegate, and the delegate's conforming performance discharges the delegator's contractual obligation. If a performance is properly delegated but the obligee refuses to accept it, this will be a breach by the obligee in the same way as it would have been to refuse the delegator's own performance.

Unlike assignment, delegation does not result in a complete substitution of the delegate for the delegator. Unless the obligee agrees (either in the contract or subsequently) to release the delegator from any further responsibility, he remains obligated under the contract. He cannot unilaterally release himself from his commitment to the obligee. Therefore, if the delegate fails to perform or renders a defective performance, this is as much a breach by the delegator as his own deficient performance would have been.

The delegate's nonperformance or defective performance could also render the delegate himself liable to the obligee but this is not inevitably so. It depends on whether the delegate has assumed the duty to the obligee by promising to perform it. Such a promise could be made directly to the obligee, or it could arise where the delegate has promised the delegator to perform, and this can be interpreted as a contract for the benefit of the obligee, as an intended third-party beneficiary. It is possible, therefore, that both the delegator and the delegate will be liable to the obligee in the event of the delegate's breach.

The following example illustrates how delegation may operate: Owner enters into a contract with Painter under which Painter undertakes to repaint the exterior of Owner's home for $5,000. Just before the work is due to begin, Painter decides that he does not wish to do the painting himself, so he hires Subcontractor to do it. (There is no assignment here because Painter does not transfer his payment right to Subcontractor, but makes a separate contract to pay him an hourly wage.) The delegation is established by a separate contract between Painter and Subcontractor under which Painter engages Subcontractor to do the job. (Painter may keep a profit from the transaction by paying Subcontractor less than the price to be paid by Owner.) Assuming that Owner's contract with Painter does not expressly prohibit delegation or contemplate that Painter does the work personally, Painter's delegation of the performance is likely to be permissible. However, if Painter had been engaged to paint a mural on the side of the house, there would be a strong argument that the contract is based on his individual craftsmanship, and his performance may not be delegated. Delegation is shown in Diagram 19H.

Diagram 19H



§19.3.7 "Assignment" of the Contract: The Assignment of Rights and Delegation of Duties

In the immediately preceding example involving the house painting contract, Painter did not assign his rights against Owner. He retained his right to her contractual performance (payment of the $5,000) and made a separate arrangement to remunerate Subcontractor. However, Painter could have decided to transfer his entire package of rights and duties under the contract. This is sometimes referred to loosely as an assignment of Painter's contract. Restatement, Second, §328(1) more properly characterizes it as both an assignment of Painter's rights under the contract and a delegation of his duties. (UCC §2.210(4) provides similarly for the assignment of a contract for the sale of goods.) Painter is an obligor who delegates and an obligee who assigns. Subcontractor is the assignee of his rights and the delegate of his duties, and Owner is both the obligee as regards the delegated duty and the obligor as regards the assigned rights.

The transaction is subject to the rules governing both assignment and delegation. Where a contract is assigned as a whole, the assignment of rights may be unobjectionable, but the delegation of duties may reduce the value of the return performance reasonably expected by the original party. If so, the contract may not be assigned. This occurred in *Sally Beauty Co., Inc. v. Nexxus Products Co., Inc.*, 801 F.2d 1001 (7th Cir. 1986). Best Barber and Beauty Supply Co. was an exclusive distributor of Nexxus products. It sought

to assign the exclusive distributorship to Sally which was owned by a competitor of Nexxus. Nexxus objected to the assignment of the contract on the grounds that the contract was for personal services and was based on a relationship of trust and confidence between the officers of Nexxus and Best. The court found the assignment of the contract was not permissible. There was no problem with the assignment of rights because the contract did not involve services of a special or unique nature and the relationship between the management of Nexxus and Best was irrelevant. Even in the absence of assignment, corporate officers can change and neither party had the guarantee that they would be able to deal with the same officers throughout the term of the contract. However, the delegation of Best's duties under the distributorship deprived Nexxus of the benefit of its bargain because the distribution of its products would be in the hands of its competitor. (The dissent felt that this was not a good reason to preclude delegation because Sally would be obliged to use best efforts in selling Nexxus products.)

§19.3.8 Grounds for Insecurity Following Assignment or Delegation

When the assignment of a right or the delegation of a duty does not clearly impair the obligee's expectation of performance, but it gives the obligee reasonable grounds for insecurity, Restatement, Second, §317, Comment *d*, and UCC §2.210(5) recognize the obligee's right to demand adequate assurances of performance. In an assignment, the assignor could be called on to assure the obligor that the transfer of rights will not impair the obligor's prospect of return performance. In a delegation, the obligee may demand the assurance of proper performance, as appropriate, either from the delegator or the delegate. This process is equivalent to the demand for assurances discussed in section 17.7.5, when a promisee is concerned about the possibility of repudiation. If, following a justifiable demand, the person to whom it is addressed gives an adequate assurance that the performance will be rendered in accordance with the contract, the reasonable concern about impairment is resolved. If adequate assurances are not given, the assignment or delegation may be objected to. In some circumstances, the lack of assurance of performance may go beyond precluding effective transfer. It could amount to a repudiation by the assignor or delegator, permitting the other party to seek relief for anticipatory breach.

§19.4 A TRANSNATIONAL PERSPECTIVE ON THIRD-PARTY BENEFICIARIES, ASSIGNMENT, AND DELEGATION

The CISG does not deal with third-party rights. Therefore, in a sale of goods subject to the CISG, the question of whether a nonparty can enforce the contract as a third-party beneficiary, or whether contractual rights or duties can be assigned or delegated, must be determined by governing domestic law. The UNIDROIT Principles do cover both these areas. Third-party beneficiaries are covered by Articles 5.2.1 to 5.2.6, and assignment and delegation are covered by Articles 9.1.1 to 9.3.7.

Articles 5.2.1 to 5.2.6 of the UNIDROIT Principles are short and quite general. They recognize that the parties to a contract may expressly or impliedly confer rights on an identifiable third party, and that the beneficiary's rights are determined by the agreement of the parties. The beneficiary's rights are subject to any defense that the promisor could assert against the promisee, and the parties to the contract may not modify the rights conferred on the beneficiary after he has accepted or acted in reliance on them. Beyond this, the UNIDROIT Principles provide no detailed principles to govern the enforcement rights of the beneficiary.

Articles 9.1.2 and 9.1.3 of the UNIDROIT Principles permit either the partial or full assignment of a monetary obligation. A nonmonetary obligation may be fully assigned (or it may be assigned in part only if it is divisible) if the assignment does not render the obligation more burdensome. Under Article 9.1.7, assignment is accomplished by simple agreement between the assignor and assignee, without the obligor's consent. However, Article 9.1.10 states that until the obligor receives notice of the assignment, his duty under the contract is discharged by performing in favor of the assignor. Under Article 9.1.13, the obligor may raise against the assignee all defenses that he could have asserted against the assignor and may exercise against the assignee any setoff right that arose before notice of the assignment.

Articles 9.2.1 to 9.2.8 of the UNIDROIT Principles deal with the "transfer of obligations," which is approximately equivalent to delegation. (Articles 9.3.1 to 9.3.7 cover assignment of the contract as a whole—they essentially combine the principles relating to assignment and transfer of obligations.) Articles 9.2.1 and 9.2.3 of the UNIDROIT Principles provide

for the transfer of obligations with the consent of the obligee. Unless discharged by the obligee, the original obligor remains liable for the performance. Transfer of obligations without the obligee's consent is possible under Article 9.2.6 unless the performance is essentially personal in character. The transfer does not free the original obligor from his contractual duties. Under Article 9.2.7, the new obligor acquires all the defenses that could have been asserted by the original obligor.

Examples

1. Tess Tatrix decided to leave her entire estate to Patty Third, her lifelong friend. She consulted Mel Practice, an attorney, for the purpose of making a will and instructed Mel to make Patty her heir. Mel drafted the will and Tess signed it. Tess died about a year later. It was then discovered that Mel had drafted the will so incompetently that it was invalid. As a result, Tess was declared to have died intestate. Patty inherited nothing from her estate, which was distributed to Tess's distant relatives. Does Patty have any cause of action against Mel?

2. Every year, Fair City holds a weeklong celebration to commemorate its founding. This year it decided to set up a funfair in one of the city parks. It contracted with Meandering Merriment Co. to erect and operate the funfair for the week. Carr Parker owns a plot of vacant land a couple of blocks away from the park. When he heard that the fair was to be held so close to his property, he realized that parking would be at a premium in the area and that he could make a considerable amount of money by using his land as a parking lot. A month before the fair was due to open, he cleared the weeds and debris off the lot and leveled it so that cars could drive onto it. He painted signs and built a little booth at the entrance. Two weeks before the fair was to begin, Meandering Merriment notified Fair City that it had double-booked for the week in question and could not set up the fair as agreed. It thereby repudiated its contract with Fair City. It was too late for the city to be able to make alternative arrangements, so it canceled the funfair.

   Carr has made careful projections of his expected profits for the week of the fair, based on the anticipated attendance at the fair and the number of cars that could be accommodated on the lot on each day. Assuming that he can establish his lost profits with reasonable certainty,

should he be able to recover them from Meandering Merriment?

3. After Rock Sparkler and Di Amond had been dating for about a year, they decided to become engaged. They visited the showrooms of Belle Bijoux, a jewelry dealer, to pick out a ring. After examining the selection for some time and receiving solicitous guidance from Belle, Di and Rock agreed on a diamond ring priced at $4,500. Rock purchased the ring, took delivery of it, and placed it on Di's finger.

   About six months later, Rock fell in love with another woman and broke off his engagement to Di. To assuage his guilt at abandoning her, Rock told Di that he did not want the ring back. Di no longer wished to keep the ring, and she decided to sell it. She took it to an appraiser to get an accurate assessment of its value. On examining the stone, the appraiser told her that it was not a diamond at all but merely a piece of cut glass.

   Di is very bitter about the breakup of her engagement to Rock, and she does not want to ask for his help in making a claim against Belle. Does Di have any basis for proceeding directly against Belle?

4. Ben Derfender's car was damaged by a hit-and-run driver. He claimed the $10,000 cost of repair from his insurer, but the insurer rejected his claim because he failed to report the collision in time. Ben retained Connie Flicted to represent him in challenging the insurer's denial of liability. The merits of Ben's claim were good, but the case was proceeding slowly and Ben needed some cash immediately. He therefore entered into a contract with Lon Shark under which Lon lent him $5,000. Ben undertook to repay the loan and interest to Lon as soon as he received payment of his pending claim against his insurer. Lon had Ben sign a letter in which he acknowledged his debt to Lon and agreed to pay the loan with interest from the proceeds of his claim. The letter ended by stating that Ben authorized his attorney, Connie Flicted, to pay Lon directly out of the proceeds. Ben gave the letter to Connie.

   About a month later, Connie settled Ben's claim against the insurer for $10,000. She had forgotten about Lon's letter and Ben did not remind her that $5,000 of the proceeds plus interest had to be paid to Lon. Connie retained her fee of $3,000 and paid the balance of $7,000 to Ben. Ben immediately spent the money and cannot repay Lon. Does Lon have grounds to recover the debt from Connie?

5. Gator Deli sells kosher food to the local orthodox Jewish community. For many years it had bought all its sausages from Frumme Mentsch, a devout member of the congregation and a strictly observant kosher butcher. Frumme decided to retire and sold her business to Chazzer Food Corp., a large corporation that supplies food to the general market. As part of the sale of her business, Frumme assigned to Chazzer her two-year contract to supply sausages to Gator. Chazzer makes all its sausages in a huge plant in which it processes meat from a variety of animals. Neither the plant itself nor the meat used by Chazzer to make sausages is kosher. The contract says nothing about assignment. Can Gator object to the assignment of the contract?

6. Manny Quinn sells high-quality leather products. His store is well known for its exquisite alligator-skin purses. He buys the cured skins and gives them to his old friend Dell E. Gator, who makes them into the purses of his own design. Dell is a talented designer and is obsessively exacting in his craftsmanship. Manny has had a warm friendship with Dell for years and has relied on him for a long time to produce exceptionally fine purses. Last year, Manny and Dell entered into a five-year contract under which Dell undertook to make a stated quantity of purses for Manny each year.

   A year after the contract was executed, Dell decided to retire to his cabin in the Everglades. He sold his business to Ann Phibian, his sulky and sullen apprentice. As part of the sale, Dell assigned Manny's contract to Ann. Ann has been well trained by Dell. Her designs are not as imaginative as Dell's but her craftsmanship is impeccable. However, Ann has an unpleasant nature and Manny finds her intimidating. He cannot face the thought of dealing with her over the next four years. He would prefer to terminate the contract and find someone else to make the purses. May he do so?

7. Percy Nality is a celebrity by profession. He entered into a contract with Hall Carnegie, an entertainment promoter, under which Percy would be paid $100,000 to deliver a speech as part of a special "Celebrity Lecture Series" that Hall intended to organize in the grand ballroom of a plush big-city hotel. Percy was paid his fee in advance upon signing of the contract. A few weeks before the speech was to be given, Hall decided that Percy had probably been a bad choice for his series because he was

quite a boring person and had very little of consequence to say. He therefore booked another speaker for the event.

To recover some of what he had paid Percy, Hall sold his contract with Percy to Rich X. Centric, who notified Percy that he had bought the right to Percy's performance. Rich informed Percy that instead of speaking in the "Celebrity Lecture Series," Percy was to come to Rich's home on the night set for the lecture, so that he could deliver his remarks to Rich and his wife in their living room. Percy refused and demanded that Hall allow him to speak at the event originally agreed on. Hall declined this demand and warned Percy that if he did not deliver the speech to Rich, he would be in breach of contract. Percy did not show up at Rich's house on the evening set for delivery of the speech. What are the parties' respective rights and liabilities?

8. A lessee entered into a five-year lease of premises. The lease had a clause that provided, "The lessee may not assign this lease or any rights or interest in it without the express written permission of the lessor. Any such unauthorized assignment shall be void and shall give the lessor the right to terminate this lease immediately." A year after entering the lease, the lessee wishes to sublet the premises, but the lessor refuses to give permission. Is there anything that the lessee can do?

Explanations

1. Tess was not indebted to Patty, so Patty has no claim against the estate as a creditor and the invalid will left her with no basis for claiming testamentary rights. If she has any recourse at all for the loss of her inheritance, it will be against Mel. Mel's incompetence in drafting the will sounds like a clear case of malpractice, which would have given Tess, his client, a cause of action against him. However, Tess is dead, and her estate itself has no reason to pursue a malpractice claim against Mel—it is not the estate but Patty who has been injured by Mel's incompetence. Patty might have a tort-based malpractice claim against Mel if she can show that Mel had assumed a duty of care toward her. While this is a possibility, it is a difficult case to make. Because of the concern that potential liability to a nonclient could interfere with the attorney's focus on the best interests of the client, courts do not lightly find that an attorney assumed a duty of care toward a nonclient unless

the attorney actually communicated with the nonclient and gave her some undertaking, or made some misrepresentation to her.

Even if Patty has no tort-based malpractice claim against Mel, she may be able to argue that she has a cause of action against him as an intended beneficiary of his contract with Tess. She would have to show that Mel and Tess intended to confer an independent right of enforcement on her. Had the contract between Tess and Mel made their intentions clear, this would have been an easier case. However, in the absence of clearly expressed intent, the court has to determine intent as a matter of interpretation or construction. Some courts have been willing to recognize such an intent in situations involving incompletely drawn testamentary dispositions on the basis that the client is now deceased, the estate has no interest in pursuing the claim against the attorney, and the disappointed heir is the only party to hold the attorney accountable for his breach of duty. Other courts are resistant to finding intended beneficiary status in the nonclient out of the same concern that influences courts in the area of tort liability: Allowing an independent cause of action to the nonclient would compromise the attorney's duty of undivided loyalty to the client by making it difficult for the attorney to focus on the client's interests while trying to avoid possible liability to the nonclient.

2. Carr has no contract to provide parking for the fair, either with Fair City or with Meandering Merriment. His only basis for recovery against Meandering Merriment is as an intended beneficiary of its contract with Fair City. Unquestionably, Fair City's intent in organizing the fair was to benefit the public generally as well as the local economy, including nearby entrepreneurs like Carr who were in a position to reap profits from the event. Actions by government bodies are usually intended to benefit citizens, but that does not mean that they are intended to confer a private right on any individual citizen to enforce the contract. In fact the usual assumption is that a private enforcement right was not intended unless the contract or any legislation authorizing it indicates otherwise or the public interest requires recognition of private enforcement rights to give effect to the governmental purpose. In the absence of such circumstances, it is solely up to the government body to decide whether to enforce its contracts. Too ready a recognition of private enforcement rights would harm the public interest by increasing the volume of

litigation and making it difficult for government to function. In Carr's case there is nothing to show that the contract, its authorizing statute, or public policy conferred the right on Carr to sue Meandering Merriment. The city had given him no commitment to hold the fair, there is no evidence that the contract contemplated any benefit to him specifically, and there is no strong public interest at stake that can only be protected by allowing Carr a right of action.

3. If Belle knew that the diamond was fake, she is guilty of fraud. Even if she honestly believed the diamond to be genuine, the delivery of a piece of cut glass was nevertheless a breach of her warranty that it was a diamond—whether such a warranty was given in so many words or arose by necessary inference from the price and description of the ring.[8] There is no doubt that Rock would have a cause of action against Belle for breach of warranty, but the issue is whether Di can proceed against her directly without relying on Rock to assert the claim. Although Di visited the showroom with Rock and helped select the ring, she was not a party to the contract for its sale. Her only basis for a direct claim against Belle (in the absence of some consumer protection statute that may extend rights to her) is as an intended beneficiary of Belle's contract with Rock. Although this is a sale of goods, UCC Article 2 has no provisions dealing with third-party beneficiary rights, which are therefore governed by common law.

   It is clear that Rock intended Di to have the ring. This was obviously apparent to Belle at the time of contracting because she knew Rock was buying an engagement ring and saw Di participate in its selection. Of course, this is not enough on its own, because there must also have been an understanding between the parties that Di would acquire an independent right to enforce Belle's contractual warranty. Although it is unlikely that the parties would have discussed this, or even thought of it at the time, intent to confer a right of action on the beneficiary need not be articulated if, under all the circumstances, it is, in the words of Restatement, Second, §302(1), "appropriate to effectuate the intention of the parties." In this case, Di's close involvement in the selection of the ring and the fact that she was to receive and own it can make a plausible argument that the recognition of her right to enforce Belle's warranty is consistent with the parties' intent.

   The facts of this example are adapted from those in *Warren v.*

Monahan Beaches Jewelry Center, Inc., 548 So. 2d 870 (Fla. 1989). In that case, the plaintiff did not participate in the selection of the ring and was not known to the seller at the time of its purchase. However, the seller did know that its customer, the plaintiff's fiancé, was buying it as an engagement ring. After her fiancé gave her the ring, the plaintiff noticed a chip in it and took it back to the seller, which undertook to replace it as soon as new inventory came in. The plaintiff kept the ring while she was waiting for the new stock and decided to have it appraised. The appraisal revealed that the diamond was not genuine, but was cubic zirconia. The plaintiff then sued the seller directly. The seller responded by moving to dismiss her complaint on the basis that it did not allege sufficient facts to show that she was an intended beneficiary of the seller's contract with her fiancé. The appellate court found that the complaint did set out a cause of action. By alleging both the seller's pre-contractual discussions with the plaintiff's fiancé and its post-contractual dealings with the plaintiff herself, it adequately pleaded an intent to confer an enforceable benefit on the plaintiff. (The post-contractual dealings in *Warren* were useful bolstering evidence because they constituted a course of performance that helped establish that the contracting parties intended to confer a right of enforcement on the beneficiary. Although no such evidence exists in Di's case, her evidence of the pre-contractual dealings is stronger than in *Warren*, and should be enough, on its own, to establish intent.)

4. Lon is clearly not an intended beneficiary of the contract in which Connie agreed to represent Ben because he was not contemplated as a beneficiary at the time that the contract was made. Also, Ben's mere sending of the letter to Connie does not give rise to a contract between Lon and Connie, and Lon has no promissory estoppel claim against Connie because he did not take action in reliance on any promise by her to transmit the proceeds to him. Although Connie was negligent in disregarding the letter, Lon is not her client and the facts do not indicate that she gave him any undertaking or even that she ever communicated with him at all. To protect the attorney-client relationship, courts are reluctant to allow a nonclient to sue an attorney for negligence unless the attorney has assumed a duty of care to the nonclient. In the absence of any communication with Lon, it seems unlikely that a court would find a duty of care.

Therefore, Lon’s only basis for recovering from Connie is as an assignee of Ben’s claim against her. An assignment is a voluntary manifestation of intent by the owner of the right to transfer it immediately and irrevocably to another. Unless the right is embodied in a negotiable instrument or document, the assignment does not need to comply with any formalities. Nor does it need to use any particular form of words, provided that intent to assign is apparent. Ben’s letter acknowledges his debt to Lon and authorizes payment to him from the fund. Its reasonable import is that Ben intends irrevocably to assign his right to the funds to the extent stated. There is nothing in Ben’s contract with Connie, or in the nature of the transaction, or as a matter of policy, that would rebut the usual presumption in favor of the free assignability of Ben’s contract rights.

This is the assignment of a present right, not the transfer of a future right. The contracts giving rise to the claim against the insurer and Connie were both in existence at the time of the assignment, even though the claim against the insurer was not yet liquidated at that stage and the claim against Connie was conditional on her receiving the proceeds of the claim against the insurer. An unliquidated, contingent claim can be assigned.

Ben had anticipated that his right against the insurer would exceed the amount due to Lon for principal and interest, so he contemplated a partial assignment of his right. This is permissible provided that the splitting of the right does not impose a substantial risk or burden on Connie, the obligor. Where the right simply involves payment from a fund, a partial assignment is not likely to be burdensome or risky to the obligor.

A valid assignment is binding on the obligor as soon as she receives notice of it. (If she so requests, she is also entitled to receive adequate proof of it.) At that point, the assignee is substituted for the assignor as the party entitled to performance and the obligee can only discharge her contractual duty by rendering performance to the assignee. Connie’s payment to Ben was improper and does not discharge her obligation to pay Lon. (Her liability to Lon under the assignment does not raise the same concern as the recognition of a negligence cause of action, because payment to Lon would be in accordance with an undertaking to Ben.)

5. Upon selling her business to Chazzer Food Corp., Frumme assigned to it her entire contract with Gator Deli—she both assigned her right to payment and delegated her duty to supply sausages. Because this is a sale of goods, the rules governing the assignment of rights and the delegation of duties are set out in UCC §2.210. The contract does not mention assignment, so §2.210 allows Gator to resist the assignment and delegation only if it would materially affect its rights and obligations under the contract, or the contract gives it a substantial interest in having Frumme personally render or control the performance. Frumme is a strictly kosher butcher, and had the contract been assigned to another strictly kosher butcher, Gator would probably have had no grounds to complain. There is nothing to suggest that Frumme's skills and attributes makes it crucial that she personally performs under the contract. However, the contract was assigned to a corporation that supplies food to the general market with a centralized butchery that neither uses kosher meat nor processes it in accordance with Jewish law. It is surely a material term of the contract that the sausages are kosher, and the delegation of the duty to supply them fundamentally affects Gator's rights under the contract.

   However, this does not mean that Gator has the immediate right to refuse the delegation and to declare Frumme to be in breach. The law's presumption in favor of assignability seeks to balance the rights of Frumme to sell her assets against Gator's right to achieve its contractual expectations. Therefore, as Chazzer has not stated that it will not comply with Frumme's contractual obligation to supply sausages that are kosher, Gator has to give it the opportunity to declare its intentions with regard to performance. Under §2.210(5) Gator should treat the delegation as creating reasonable grounds for insecurity, and should clarify Chazzer's intentions by demanding an adequate assurance of performance. If Chazzer fails to provide an adequate assurance of performance, Gator has the right to refuse the delegation. In addition, because Frumme repudiates the contract by improperly delegating her duties, Gator can declare a material breach and can claim damages from her for any loss that it suffers. However, if Chazzer responds by giving the assurance that the sausages to be supplied under the contract will be processed separately from nonkosher meat in a plant and under a process that complies with Jewish law, Gator must accept the assignment and

remains bound by the contract. (Remember that even if the delegation is effective, it does not release Frumme from her obligations, and she remains responsible if Chazzer fails to perform properly.)

6. Dell's contract with Manny is for services, not the sale of goods. It is therefore subject to the common law. However, the common law principles are no different from those set out for a sale of goods in Example 5. Like the contract for the sale of sausages, this contract is assigned in its entirety and constitutes both an assignment of Dell's right to payment and his duty to make the purses. The contract is silent on assignment, so the rights are presumed to be assignable and the duties delegable unless this would violate public policy (which is not implicated here) or the nature and purpose of the contract is such that assignment would place an undue burden on Manny, would impair his prospects of return performance, or would defeat his substantial interest in having the obligor render or control the performance.

   Manny's contract with Dell is highly personal in two respects. First, it is based on Dell's exceptional talent in design and craftsmanship. Second, it is grounded in a long and congenial relationship. The quality of Ann's work is equivalent to Dell's but she does not quite have his design flair. Dell's identity is clearly a significant factor in the contract, as would be true of any artist. This could be an important enough a feature of the contract to make Dell's personal performance the basis of the bargain. However, we cannot be sure of this without knowing more about the extent of the differences between his and Ann's work. The significance of the personal relationship is even more difficult to evaluate. Manny may not have entered into a long-term contract with someone with whom he did not have a good personal relationship. However, this is a commercial contract for the purpose of producing marketable products. Provided that purses of suitable quality can be produced, the parties do not have to be buddies, and their happy personal relationship may be incidental to the central purpose of the contract.[9]

   In short, there is a chance that Manny could resist assignment of the contract, but this result is not assured. When the court balances Manny's reasonable contractual expectations against Dell's right to profit from the sale of his business, it could well find that Manny has not met the burden of showing this contract to be nonassignable.

7. If Hall's obligation under the contract is interpreted to be nothing more than the payment of the speaking fee, then Hall has fully performed and his sale of the contract is merely an assignment of his right to have Percy blabber for an hour or so. If this is the correct interpretation, then the performance due to Percy in return for the speech is not jeopardized because it has been paid, and unless Rich's house is substantially less accessible than the plush hotel, there seems to be little burden imposed on his ability to render his performance. The assignment of the right would therefore be unobjectionable.

   However, it is more than likely that Percy did not bargain only for the fee, but also had a reasonable expectation of enjoying the prestige and exposure of participating in the lecture series. This right may or may not have demonstrable economic value, but its economic worth is not the issue. Even intangible or speculative benefits can be a material part of the bargain if they are reasonably contemplated by the parties. On this interpretation, the sale of Percy's performance also entails the delegation of Hall's duty to make provision for the delivery of the speech as contemplated by the contract. (Or, to put it differently, Hall's assignment of his right to receive the speech materially reduces the value of the return performance due to Percy or impairs his chance of receiving it.)

   If this is so, it follows that the assignment of the contract was a repudiation, and when Hall refused to retract before the due date for performance, he materially violated his contractual promise. This gave Percy the right to withhold his own performance and to sue Hall for damages. Presumably at that late date Percy had no opportunity to mitigate by finding another lucrative engagement, so he can at least keep the $100,000 as direct damages. (Assuming that this would have all been profit, and that he would not have had to incur costs in performing.) It may be possible for him to establish some economic loss for being deprived of the ability to speak in the lecture series, but such a loss is probably too uncertain and speculative, so consequential damages are unlikely to be provable. In addition, Hall is liable to Rich for failure to perform that contract. In transferring his right to Rich, Hall impliedly warranted the existence and validity of the right assigned. Therefore, if it was nonassignable, Rich can sue Hall for breach of this warranty. As he is unlikely to have suffered any consequential loss, his claim is probably

confined to restitution of what he paid for the right.

By contrast to Percy's case, a right to the performance of personal services was held to be assignable in *Evening News Assn. v. Peterson,* 477 F. Supp. 77 (D.D.C. 1979). Peterson was employed as a news anchor at a television station. When the television station was sold, the seller assigned Peterson's employment contract to the buyer. Peterson objected to the assignment, but the court upheld it. The assignment of the contract did not materially alter his working conditions, increase his burden of performance, or endanger his prospects of return performance.

8. Because the law has a general preference in favor of the assignability of rights and the delegation of duties, courts interpret clauses prohibiting or restricting assignment as narrowly as possible. The provision in the lease is clearly worded and it therefore must be taken to preclude effective transfer without the lessor's permission. As the lessee needs permission to sublet, we must now consider if there is anything that can be done to compel the lessor to give its permission or to override its refusal. Unless the lease makes it clear that the lessor reserves absolute discretion to refuse permission, the law implies an obligation on the lessor to act reasonably in refusing it. This accords with the normal marketplace expectation of commercially reasonable conduct and is consistent with the law's general policy of requiring parties to deal with each other fairly and in good faith. Therefore, to legitimately refuse permission to sublet, the lessor must show that it has reasonable grounds for objecting to the subtenant—for example, that it is financially unstable, would use the premises improperly, or would otherwise be an unsuitable occupant.

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1. *See* section 18.13.1 for a discussion of mental distress damages.
2. Of course, consideration is generally required too, as discussed in sections 7.5.2 and 13.9.
3. The assignment of rights under an executed contract must be distinguished from the rule that applies in the precontract period. As noted in section 4.7, the power to accept an offer is personal to the offeree and cannot be transferred unless the offer so authorizes. This rule does not apply to a valid option—a promise exchanged for consideration not to revoke the offer. As explained in section 4.13.3, the option is a contract in itself and the right to accept the offer in the option period is a binding contractual right. It can therefore be assigned.
4. This prohibition against the assignment of tort claims for personal injury has ties to the age-old common law policy against maintenance and champerty—the promotion of litigation for profit by persons who finance it in exchange for receiving part of the proceeds.
5. Of course, as it is an intangible right, its value is dependent on Borrower's creditworthiness. It will therefore not be sold at its face value, but its price will be discounted to take account of the risk of default. This discount, together with the prospect of earning the interest payable by Borrower under the contract, may make this an attractive purchase for a buyer like Finance Co. that is willing to take the risk of default in the hope of gaining more than it paid.

6. It is common for an assignment to be used for the purpose of securing a loan. While an important aspect of commercial transacting, the transfer of intangible rights as security is subject to complex and detailed rules that are beyond our scope. However, a brief description of the basic structure of such a transaction may be helpful: The owner of the contract right does not sell it outright, but instead borrows the needed funds and transfers the right to the lender as security for his promise to repay the money. In such a case, the transfer is not absolute. The secured creditor retains an interest in the contract right until such time as the loan is repaid but has the right to foreclose on the security and collect payment of the contract performance in the event that its debtor defaults. There are variations on this format that need not concern us here.

7. Here again, there are special rules concerning the transfer of negotiable instruments and documents, for which notification alone is not enough.

8. UCC §2.313(1)(b) provides that a description of the goods that is made part of the basis of the bargain creates an express warranty that the goods conform to the description.

9. It is noted in section 19.3.7 that a contracting party has no right to expect that he will continue to deal with corporate officers with whom he has a special relationship because officers can change even in the absence of assignment. This consideration is inapplicable where the contracting parties are individuals. However, the personal relationship of the parties might still be incidental, even in a contract between individuals.

Glossary

Accord and satisfaction. A settlement of an existing claim under which the parties agree that one of them (the debtor) will give, and the other (the creditor) will accept a lesser performance than that originally claimed by the creditor. The agreement of settlement is the accord, and its execution by rendition of the settled performance is the satisfaction. Until the settlement is satisfied by performance, it is known as an executory accord.

Actions of assumpsit, covenant, and debt. *See* Assumpsit; Covenant; Debt.

Adhesion. A contract is adhesive where the party who drafts the terms of the contract has the ability to insist that the contract may be only on its terms, and the other party has no choice but to agree to the terms if he wishes to enter the contract. That is, the terms are nonnegotiable and the nondrafting party has no choice but to adhere to them if he wants the contract.

Agreed damages. *See* Liquidated damages.

Agreement to agree. Negotiating parties may have reached agreement in principle, but may not have settled all the terms of their proposed contract. They may decide to postpone resolution of those terms for later, agreeing to address them at a future date. This situation is sometimes described as an "agreement to agree." If the unresolved terms are material, no contract can come into existence until they are settled, so an "agreement to agree" is not a contract. However, the parties may have promised expressly or impliedly to continue to negotiate in good faith.

Anticipatory repudiation. A contract cannot be breached before the time of performance falls due. However, if, before his performance is due, a party makes it clear by unequivocal words or unambiguous voluntary conduct that he will not perform as promised, or will materially breach the contract when the time for performance arrives, he repudiates in anticipation of performance. The other party may react to this repudiation immediately and pursue relief for breach. *See also* Prospective nonperformance.

Arbitration. The parties may provide in the contract itself, or in a self-standing separate agreement, that any disputes relating to their contract will be resolved by a neutral third party (an arbitrator). By agreeing to

arbitrate disputes, the parties forgo the right to litigate, and they bind themselves to the arbitrator's disposition.

Assignment and delegation. Assignment is the transfer of a contractual right, and delegation is the transfer of a contractual duty. Sometimes "assignment" is used more loosely to mean the transfer of a contract in its entirety, which involves the transfer of both rights and duties under the contract.

Assumpsit. (Latin: "He undertook.") One of the common law forms of action under which suit was brought for damages for the breach of a contractual promise. Assumpsit, an extension of the tort action of trespass, was originally only available where the defendant performed improperly, causing harm to the plaintiff (misfeasance). It was later extended to cover situations in which the defendant broke his promise by failing to perform at all (nonfeasance). As assumpsit developed, it became the most flexible, efficient, and comprehensive form of action for contract. It eventually overtook the other contractual writs of covenant and debt, emerging as the forebear of modern contract law.

Assurance of performance. *See* Prospective nonperformance.

Avoidable contract and **avoidance.** An avoidable contract is one that has some defect (typically resulting from improper bargaining, illegality, or incapacity) that allows one of the parties to **rescind** or **disaffirm** the contract. If that party does not elect to rescind, the contract is enforceable. An avoidable contract must be distinguished from a **void** contract, which is a nullity and cannot be enforced by either party.

Balance of the equities. *See* Equitable balancing.

Bargain theory. *See* Consideration.

Battle of the forms. A nickname given to the situation in which the buyer and seller of goods attempt to form a contract by exchanging writings with mismatching terms. Often these terms are preprinted standard provisions, designed to protect the interests of the sender.

Bilateral contract. All contracts have two or more parties, so every contract is at least bilateral (or, if not, multilateral) in the lay sense. However, in contract law, the word "bilateral" is a term of art, meaning that at the instant of contract formation, there are promises outstanding by both parties. This is in contrast to a unilateral contract, under which the offeree's act of acceptance is also her act of performance, so that at the instant of formation, the offeree has already performed, and only the

offeror's promise is outstanding. Most contractual relationships involve an exchange of promises, so most contracts are bilateral. Unilateral contracts are less common. *See also* Unilateral contract.

Boilerplate. Standard provisions commonly employed in contracts of a particular kind, and often set out in preprinted standard form contract blanks.

Boxtop terms. Standard contract terms set out or referenced on a box or other container that includes a product such as goods or software.

Breach of contract. *See* Materiality; Partial breach; Substantial performance; Total breach.

Browsewrap. Standard contract terms set out on a website or other electronic medium and available to be read by the user (commonly by clicking a link to the terms) before submitting an order for the product or services purchased. Browsewrap differs from clickwrap in that it does not require the user to signify assent to the terms before completing the transaction.

Chancery. The Chancellor's Court. That is, the court of Equity. *See also* Equity.

CISG. Abbreviation for the United Nations Convention on Contracts for the International Sale of Goods. The CISG governs international sales of goods by parties whose places of business are located in signatory states. The CISG does not apply to consumer transactions or to transactions in which the parties have excluded it by agreement.

Civil law. A general term used to describe the legal system of countries that derive their legal heritage from Roman law. Within our legal system, the term is also used to describe the law governing private rights and relationships, as opposed to criminal law.

Class action. Where a large group of people all have the same claim against a defendant, a small group of named plaintiffs may commence a suit against the defendant in which they represent not only their own interests but those of the entire class.

Classical contract law. The name used to describe the law of contracts as it existed in the period running from the late nineteenth to early twentieth century, in which modern contract law was developed and systematized.

Clickwrap. Standard contract terms contained in a website or software and set up in a way that requires the user of the site or software to access the terms and to signify assent to them, usually by action such as clicking an "I agree" button. *Compare* Browsewrap.

Common law. A term with three related but distinct meanings. It denotes:

1. The basic legal system of countries whose law derives from the common law of England.
2. The judge-made (as opposed to statutory) component of our law.
3. The process of legal analysis under which judges interpret, develop, and embellish rules of law.

Comparative law. The comparative study of the laws or legal systems of two or more nations.

Concurrent conditions. Where mutual performances under a contract are dependent on each other and the contract does not expressly or impliedly set out a sequence for performance, they must be rendered at the same time, and each performance is deemed in law to be a condition of the other. Therefore, if one of the parties fails to perform, the other is excused from doing so.

Condition. An event, not certain to occur, that must occur for the performance of a party to become due. If the parties agree that a particular performance under the contract (or the entire contract) is to be contingent on the happening of a future uncertain event, the performance (or the contract as a whole) is conditional. A condition is **express** if it is articulated in the agreement; **implied in fact** if it is inferable from interpreting the agreement in context; or **construed (or implied in law)** if the court concludes, as a matter of legal implication, that the parties reasonably intended it. Conditions are also categorized as pure or promissory. A **pure condition** is simply an event specified as a contingency on which performance is dependent, and nothing more. If the event fails to occur, the performance dependent on it need not be rendered, and neither party incurs any liability for the nonoccurrence. However, a **promissory condition** is both a condition and a promise. That is, one of the parties promises expressly or impliedly that the condition will occur, and becomes liable for breach of contract if it does not.

Conditions precedent or subsequent. A condition precedent is one that must be fulfilled before a duty to perform comes into effect. A condition subsequent is one that discharges a duty of performance. That is, the duty to perform arises immediately upon formation of the contract, but if the condition occurs, it falls away. A condition subsequent differs from a

condition precedent in that it extinguishes an existing duty, while a condition precedent is a precondition to a duty arising. The distinction is arcane and in most cases it makes very little difference to the outcome of a case. The term “condition subsequent” is not used much anymore, and the law’s general assumption is in favor of a condition precedent.

Consequential damages. Losses or injuries suffered by the victim of a breach going beyond the mere loss in value of the promised performance (direct damages) and resulting from the impact of the breach on other rights, transactions, or endeavors affected by the contract.

Consideration. In its earliest formulation, “consideration” probably meant no more than that the contract was deliberately considered—that it was seriously contemplated and intended to be binding. As it has developed, consideration has come to mean that something of legal value (but not necessarily economic value) must be given by each party in exchange for what was promised or given by the other. Under the **bargain theory**, which prevails in modern law, a promise or performance qualifies as consideration only if it has been given in exchange for and induced the return promise or performance.

Construction/construed term. *See* Implied-in-law term.

Constructive conditions of exchange. Unless the contract expressly or impliedly indicates a different intent, the law generally presumes that the performances of the parties are interdependent—that they are **dependent promises**. That is, each party’s duty to perform is conditional on the other performing. *See also* Condition.

Contract of adhesion. *See* Adhesion.

Contra proferentum rule. A default rule of interpretation that where the meaning of language is unclear and cannot be resolved by contextual evidence, an interpretation is preferred that goes against the interests of the drafter, and in favor of the nondrafter.

Course of dealing/performance. Where contracting parties have entered into a number of successive transactions of a similar kind, the transactions that occurred before the contract in question are referred to as a course of dealing. Where there is some uncertainty in the meaning of a term in the current contract, evidence of the parties’ course of dealing can be helpful in resolving it. The conduct of the parties in performing a contract after its execution is called a course of performance. Evidence of how the parties actually performed following the formation of the contract can likewise be

useful in interpreting what they must have intended.

Covenant. In general terms, a covenant is simply an agreement, but it may also be used as a synonym for "promise." At early common law, Covenant was a form of action available to recover damages for breach of a promise under seal. Under the formalistic system of pleading in early common law, the action was not available for a contract that was not executed under seal.

Cure. A breaching party's rectification of the deficiency in performance.

Damages. A monetary award to compensate for loss or harm. *See* Consequential damages; Direct damages; Expectation damages; General damages; Incidental damages; Liquidated damages; Punitive or exemplary damages; Reliance damages; Special damages.

Debt. In its contemporary meaning, a debt is an obligation to pay money. (Sometimes "debt" is used even more broadly—and somewhat inaccurately—to denote any obligation of performance.) At early common law, the **action of debt** was a form of action that lay for recovery of a sum certain in money arising out of a contract under which money had been lent to the defendant or goods or services had been delivered to him.

Delegation. *See* Assignment and delegation.

Dependent promises. *See* Condition; Constructive conditions of exchange.

Deposited acceptance rule. *See* Mailbox rule.

Detriment. In law, "detriment" is sometimes used in its ordinary sense, to mean actual harm, prejudice, or injury. (Many courts require detriment in this sense before giving relief for promissory estoppel.) However, in consideration doctrine, "detriment" is used as a legal term of art. To suffer a **legal detriment**, a party must merely give up some legal right—do something that he is not obliged to do, or refrain from something that he is entitled to do. It does not matter if this legal detriment is of little or no economic value, or that it is not in fact harmful or injurious to the party suffering it.

Direct costs. *See* Fixed costs.

Direct damages. Losses incurred by the victim of a breach in acquiring the equivalent of the performance promised under the contract, so as to substitute for the performance that should have been rendered by the breacher.

Direct reliance. *See* Reliance damages.

Disaffirmance. Upon breach, the victim may either sue on the contract for expectation or reliance damages, or may elect to act as if no contract exists,

and to sue for restitution under a theory of unjust enrichment. Disaffirmance is the plaintiff's formal abandonment of the contract in order to ground the unjust enrichment claim. Disaffirmance is also sometimes used as a synonym for **avoidance**.

Divisibility. A contract is divisible if the mutual performances promised by the parties can be split up into a number of smaller, self-sufficient exchanges. That is, the contract can be divided into independent and self-contained sets of matching performances. *See also* Severability.

Duty to read. Under the objective test of intent, a party is bound by the reasonable meaning of her manifestation of intent. Therefore, a party is usually deemed to have agreed to written or recorded terms if she manifests assent to them, even though she failed to read or comprehend them.

Economic waste. If damages for rectifying a breach are disproportionate to the victim's true loss, the court has the discretion to adjust them downward to more accurately reflect the actual loss. It is sometimes said that the basis for this adjustment is that it would be economically wasteful to spend a large sum on curing a relatively less valuable breach, but as the plaintiff would not be obliged to waste the damages award on rectifying the breach, the true basis for the rule is that it would be an **unfair forfeiture** to compel the breacher to pay damages disproportionate to actual loss.

Efficient breach. A breach is efficient if it makes the defendant better off without making the plaintiff worse off. If the defendant's cost to perform the contract (including the cost of lost opportunity for a more lucrative transaction) would exceed the benefit that performance would give both parties, the defendant may save (or earn) enough money by breaching to pay expectation damages to the plaintiff and still come out ahead. In purely economic terms, a breach in such circumstances does not harm the plaintiff, who is compensated by the payment of damages, while it increases the defendant's wealth. A breach can only be efficient if the transaction costs of each party in making substitute transactions and of settling or litigating the plaintiff's claim do not exceed the gains to be made from the breach. Also, it must be remembered that costs of breach are often not capable of accurate calculation, and breach has implications beyond economics.

Ejusdem generis. (Latin: "of the same kind.") A rule of interpretation under which specific words limit the meaning of general words with which they

are associated.

Electronic agent. A computer program or another automated means used by a party to initiate or respond to communications in the formation of a contract and intended to allow for contract formation without the intervention of a human operator.

Enforcement. A general word that denotes judicial recognition of a right. When it is said that a court enforces a contract, this means that the court will render judgment for relief upon breach of the contract. Enforcement does not necessarily take the form of a court order compelling the breaching party to perform his obligations under the contract—in fact such an order of specific performance is the exception rather than the rule. In most cases, the enforcement of a contract takes the form of a money judgment for damages. If the breaching party fails to pay the damages voluntarily, the means of compelling payment is by execution. *See also* Execution; Specific performance.

Equitable balancing. In judicial decisionmaking, the process under which the court takes into account the likely impact of countervailing resolutions, and attempts to reach a fair and balanced result by weighing the potential hardship to each party as well as their respective rights and the relative justice of their positions.

Equity. Apart from meaning "fairness" in a general sense, this word has a more technical meaning in the common law. It refers to the jurisdiction originally exercised by the Lord Chancellor, representing the monarch, for the purpose of granting discretionary relief when that relief was beyond the more rigid remedial powers of the law courts. A crucial requirement of seeking equitable relief was, and still is, that the available legal remedy would be inadequate. Courts of law and equity have been combined for some time, so the firm separation of law and equity has broken down considerably. However, the distinction between suits of equitable and legal origin is still maintained.

Escrow. Money or other property delivered by a contracting party to an independent third party (the escrow agent) with instructions to deliver the money or property to the other contracting party upon the fulfillment of stated conditions. By using an escrow agent, the party with the duty to deliver the property ensures that the property is not handed over to the other party until he performs, and the other party is assured of receiving the property upon performance.

E-SIGN. The Electronic Signatures in Global and National Commerce Act, a federal statute enacted in 2000, to validate electronic signatures and records, and generally, to ensure that general principles of contract formation are applied to electronic transactions. *See also* UETA.

Essential reliance. *See* Reliance damages.

Estoppel. (Also called **equitable estoppel** or **estoppel in pais.**) A doctrine derived from equity under which a person is precluded from asserting a right where she has, by deliberate words or conduct, misled the party against whom the rights are asserted into the justifiable belief that the right does not exist or will not be asserted.

Execution. The process of enforcing a money judgment, such as a judgment of contract damages, against the judgment debtor (the party against whom the judgment has been rendered.) The judgment creditor (the party in whose favor judgment was granted) has a writ issued and delivered to the appropriate official (usually called the sheriff), who then attempts to find property belonging to the judgment debtor. If such property is found, the sheriff levies on it—that is, takes legal custody of it, and after advertising it, sells it at public auction. The proceeds of the sale are then paid over to the judgment creditor.

Executory/executed. Until a contract has been fully performed, it is executory. Once it has been fully performed on both sides, it is executed. In the case of a gift, where the gift is merely promised, but not yet given, it is executory (and hence unenforceable under consideration doctrine), but once the gift has been transferred to the donee, it is executed, and no longer subject to invalidation under consideration doctrine.

Executory accord. *See* Accord and satisfaction.

Exemplary damages. *See* Punitive damages.

Expectation damages. The standard measure of damages for breach of contract—a monetary award designed to compensate the victim of breach for her reasonable contractual expectations lost as a result of the breach. The damages are intended to place the victim in the economic position that she would have been in had the contract not been breached.

Express. Articulated or stated in words, rather than inferred from indirect language or circumstances.

Expressio unius est exclusio alterius. (Latin: “the expression of one thing excludes another.”) A rule of interpretation under which the listing of a string of specific things, not followed by a general term, is taken to exclude

unlisted things of the same kind.

Extrinsic evidence. Evidence of the context in which a document was executed. These facts outside the document, such as evidence of discussions, negotiations, or prior dealings between the parties or trade usage, may help cast light on what the parties meant by the language used in the document. *Compare* Four corners (of a document).

Fiction. *See* Legal fiction.

Firm offer. An offer that the offeror undertakes not to revoke for a stated or reasonable time. At common law, such an undertaking is not binding on the offeror unless the offer qualifies as a valid option, but under UCC Article 2, a firm offer is binding under defined circumstances.

Fixed costs (overhead). Costs that must be paid by a party whether or not she ceases performance under a contract. These overhead costs are distinguished from **variable (direct) costs**, which are costs incurred solely in the process of performance, and are saved when the party ceases performance. When the plaintiff's performance has ceased as a result of the defendant's breach, fixed costs, not being saved, are included in the plaintiff's damages, but those variable costs that the plaintiff does not have to incur because of the breach are saved and are therefore not included in calculating the plaintiff's loss.

F.O.B. (Free on board.) A term in a sale of goods that identifies the seller's delivery commitment and risk of loss. The initials F.O.B. are followed by a specified place (for example, F.O.B. New York). The seller is responsible for the cost and risk of getting the goods to that place, and the buyer must accept delivery there. Upon taking delivery, the buyer assumes responsibility for the freight and risk of loss from that point.

Force majeure. (French: "superior force.") A force beyond the control of the parties, such as a natural disaster or war. A force majeure clause in a contract is one that releases a party from performance if that performance is rendered impracticable as a result of such an uncontrollable event.

Foreseen/foreseeable. An event is foreseen if the party in question recognizes the possibility of its occurrence and contemplates it as a real likelihood. However, foreseeability is based on a more objective standard: Whether or not the party in question does actually foresee the event, it is foreseeable if it can be conceived of by a reasonable person in the position of the party.

Forfeiture. *See* Unfair forfeiture.

Form of action. In older common law, different actions (for example, the contract actions of assumpsit, covenant, or debt, or the tort action of trespass) each covered a specific type of transaction or set of facts and had a particular form that had distinct features in its pleadings and in the manner in which evidence was presented and evaluated. This formalistic system no longer applies in modern law.

Forum selection clause. A term in a contract in which the parties stipulate that any litigation relating to the transaction will be commenced only in a specified court or jurisdiction.

Four corners (of a document). This refers to the face of a written document. Where a court's interpretation of a document is confined to the document itself, without reference to any evidence extrinsic to the document, the court is said to be ascertaining the meaning and intent of the document within its "four corners." The term is also used in connection with the parol evidence rule where the court confines itself to the written memorial of agreement to decide whether that writing is integrated—that is, a final and complete expression of the agreement. *Compare* Extrinsic evidence; Integration/integrated writing.

Fraud. A misrepresentation of fact, opinion, or intention, made with knowledge of its falsity and intent to mislead. Most fraudulent misrepresentations are **in the inducement**—they misrepresent something that underlies and induces the contract. In rarer cases, fraud may be **in the factum**—a misrepresentation of the nature and effect of the document signed. *See also* Misrepresentation.

Frustration of purpose. A contract's purpose is frustrated where, after it is made, an unforeseen event occurs, which so changes the circumstances surrounding it, that the contract's underlying purpose—as reasonably understood by both parties—is defeated. Although it is still possible to perform as originally intended, the point of the contract has disappeared. Under proper circumstances, the frustration of a contract's purpose is grounds for its termination.

Gap filler. A default term implied by law into a contract where the parties have not agreed expressly to a term covering that aspect of their contract. For example, if parties to a contract for the sale of goods do not specifically agree when payment must be made for the goods, the law supplies a gap filler that the price is to be paid on delivery.

Garnishment. A form of execution under which a writ is delivered to a

person who holds property of the judgment debtor or owes money or another obligation to the judgment debtor, ordering that person to turn over the property or money to the court in satisfaction of the judgment. *See also* Execution; Writ.

General damages. In contract, damages that arise in the normal course of breach, including readily foreseeable direct damages, as well as those consequential damages that were reasonably foreseeable by the breacher at the time of contracting as a natural and probable consequence of the breach. (If the breacher could not reasonably have foreseen the damages without special information or knowledge of the victim's particular circumstances, the damages are special.)

Good faith. Actual honesty and fair dealing, with an absence of intent to act wrongfully. Despite the prevalence of an objective reasonableness standard in contract law, there are many situations in which the honesty of a party, measured subjectively by attempting to ascertain his actual state of mind, is relevant to the case.

Illusory promise. An apparent promise that is so qualified, or in respect of which such wide discretion is reserved, that the apparent promisor actually makes no binding commitment at all.

Implied in fact. A contract, term, or promise is implied in fact if it is not expressly stated, but it can be deduced as a matter of factual conclusion from other language used by the parties, or from conduct or the circumstances surrounding the transaction.

Implied-in-law contract, also known as **quasi-contract**, is not a contract at all, but a legal fiction originally created for procedural reasons—to allow the formalistic common law courts of a bygone era to use the contractual form of action as a basis for giving relief for unjust enrichment. In modern law, these formalistic forms of action have long disappeared, but the terms "quasi-contract" or "contract implied in law" have survived and are now merely alternative names for the action for unjust enrichment.

Implied-in-law term, also known as a **construed** term, is a term found by the court to exist in a contract, even though the language of the contract does not state it, and it cannot be inferred as a matter of fact from contextual evidence. Legal implication is based on a policy judgment by the court (or by a statute or common law rule) that the term should be in the contract, even though the parties may not actually have agreed to it. The importation of the term into the contract is typically justified on the

basis that the parties, as reasonable people, would have intended the term to apply had they thought about the issue.

Impracticability/impossibility. Under the older, narrower doctrine of impossibility, performance under a contract may be excused as impossible if the contract contemplated that performance to be dependent on the continued existence of a person or thing, and, without fault of the person claiming excuse, the person died or thing was destroyed after the contract's execution. The doctrine of impracticability is a modern expansion of the older impossibility doctrine. A party may be excused from performance if an unforeseen supervening event, occurring after formation of the contract, and not caused by the fault of the party claiming excuse, defeats a basic assumption on which the contract was made. To establish excuse on the basis of impracticability, the party must also show that the unforeseen event imposes a significant burden on him, beyond any risk that he expressly or impliedly assumed.

Incidental/intended beneficiary. *See* Third-party beneficiary.

Incidental damages. Costs and expenses incurred by the victim of a breach in attempting to deal with it and in taking action to seek a substitute transaction or to curtail losses.

Incidental reliance. *See* Reliance damages.

Indebitatus assumpsit. *See* Assumpsit.

Indefiniteness. Vagueness, ambiguity, or other uncertainty in an agreement.

Infancy, infant. A word commonly used in contract law to mean minority—that is, to describe any person below the age of contractual capacity (typically 18).

Injunction. An order of court compelling the performance of a specified act (called a **mandatory** injunction) or prohibiting specific action (called a **prohibitory** injunction).

In pari delicto rule. (In pari delicto potior est conditio defendantis. Latin: "where the parties are in equal guilt, the defendant's position is the stronger.") This maxim applies to contracts that are illegal. If one of the parties seeks to enforce such a contract, or even to obtain restitution of performance rendered under it, the court may refuse to intervene. In making the decision on whether or not to allow relief, the court weighs the relative guilt of the parties and takes into account the equities between the parties and the public interest.

In personam/in rem. An order or command of the court directed at the

defendant and compelling him to do or refrain from doing something is an in personam order, and its disobedience will result in contempt of court. By contrast, a judgment of the court that the defendant owes monetary damages is not directed against the person of the defendant, but at his property—it is in rem. If the defendant fails to pay the judgment, it can only be enforced to the extent that the sheriff can find property of the defendant on which to levy execution.

Integration/integrated writing. A written record of agreement is said to be **totally integrated** if it clearly and unambiguously expresses all the terms agreed to by the parties, and is intended by them to be a complete and final expression of all the terms of their contract. If the written record does not fully and finally incorporate all of the agreed terms, but it does set out some of them completely, clearly, and unambiguously, it is said to be **partially integrated.** That is, the writing is a final expression of agreement with regard to those terms that are fully set out.

Interpretation. The process of inferring meaning from language or from factual evidence of the context in which the language was used.

Judgment creditor/debtor. *See* Execution.

Knockout rule. A rule applied under some circumstances to resolve the "battle of the forms" under UCC §2.207. The rule provides that conflicting terms in the parties' correspondence cancel each other out, leaving an open term to be filled by the gap fillers provided by the UCC.

Last shot rule. Where the final communication in the process of offer and acceptance contains new or different terms, the recipient is deemed to have accepted those terms by conduct if she performs without objecting to them. Although the rule is followed at common law, it does not apply in the "battle of the forms" under UCC §2.207.

Legal detriment. *See* Detriment.

Legal fiction. A factual assumption, deemed to be true in law, even though the assumed fact is not established by evidence to be true, or, in some cases, even if the assumption is contrary to the actual facts. Legal fictions are used to effectuate a public policy or to achieve a just result.

Legal realism. A philosophy of law that rejects the concept of law as a set of certain, neutral legal rules, and views it in a multidisciplinary context, in which legal doctrine is part of a larger process of decisionmaking and policymaking. The Realist school moved away from the formalism of Legal Positivism to examine not only the rules of law but also the

operation of legal rules in the broader context of the legal process, society, and social policy.

Levy. *See* Execution.

Liquidated damages. At the time of contracting, the parties may wish to avoid disputes and uncertainty over damages if a breach should occur in the future, and they may therefore include a term in the contract that fixes in advance the amount of damages to be paid if a breach occurs. A fairly bargained liquidated damages provision is enforceable provided that, at the time of contracting, it reasonably appeared to the parties that actual damages would be difficult to prove, and the parties made a genuine attempt to forecast probable loss. Many courts also evaluate the reasonableness of liquidated damages, in the alternative, in light of the actual loss ultimately suffered, and will uphold the clause if the liquidated damages are reasonably equivalent to actual loss. If a liquidated damages provision does not meet these standards, it is treated as a penalty and is unenforceable. *See also* Penalty.

Liquidated debt. A debt is liquidated when its monetary value is certain and fixed. In the context of damages for breach of contract, damages normally become liquidated once the breach has occurred, provided that the damages can be calculated by arithmetical means. If the determination of damages cannot be made purely by arithmetical calculation (for example, because there are factual issues relating to the extent of damages), the damages only become liquidated once the factfinder (commonly the jury) has assessed them.

Lost volume. If a seller of goods or services has the capacity to supply the full demand for those goods or services, a breach by one buyer is not substituted for by a subsequent sale of the goods or services to another customer who would have bought the goods or services in any event. The breach has caused a loss in the volume of the plaintiff's sales and can only be compensated for by an award of lost profits.

Mailbox rule. (Also known as **"deposited acceptance rule."**) Where an offer expressly or impliedly authorizes acceptance through the mail or an analogous noninstantaneous means of communication, the acceptance takes effect as soon as it is properly dispatched by the offeree.

Manifested intent. The apparent state of mind of a party, as demonstrated by her observable conduct or spoken or written words. *See also* Objective.

Material benefit rule. A doctrine that permits enforcement of a promise

without present consideration where the promise is made in recognition of a substantial benefit previously conferred on the promisor by the promisee, and enforcement is needed to prevent injustice. Because this doctrine is grounded in the idea that the promisor is morally obliged to honor a promise to pay for the prior benefit, it is sometimes called **"moral obligation."** This is an ambiguous term, and can easily be confused with the different usage of "moral obligation," which means simply that the obligation in question is binding only in conscience and is not capable of being legally enforced.

Materiality/material term/material breach. A term of a contract is material if it is an important component of the contract, so central to the values exchanged that it is a fundamental basis of the bargain between the parties. A material breach is a violation of a party's obligations under the contract, so serious that it defeats the other party's reasonable expectations under the contract by substantially depriving her of the value of the transaction. Materiality cannot be decided in the abstract, but must be determined by interpreting the contract.

Merchantable. Goods are merchantable if they meet minimum acceptable trade standards, and would be regarded as of adequate quality by a reasonable member of the trade.

Merger clause. A provision in a written agreement declaring that the writing contains all the terms agreed on by the parties, and that no terms, other than those expressed in the writing have been agreed to. Such a provision is called a "merger clause" because its purpose is to "merge" all the agreed terms into the writing, so that the writing becomes the full and complete record of what was agreed, and neither party can later allege that terms exist beyond those expressed in the writing.

Mirror image rule. (Also known as **ribbon matching rule.**) A rule that requires an acceptance to match the offer exactly, with no alteration or qualification. Under this rule, if the acceptance deviates from the offer in any way it does not qualify as an acceptance, but is a rejection and possibly a counteroffer. Many courts no longer apply the mirror image rule, but adopt a more flexible approach under which the response to an offer may qualify as an acceptance if its divergence from the offer is not material. In sales of goods, the rule is clearly abrogated by UCC §2.207.

Misrepresentation. An assertion not in accordance with the truth. If the misrepresentation is made with **scienter**—knowledge of its falsity and

intent to mislead, it is fraudulent. If it is made without scienter, it may be either negligent (the party making it would have known of its falsity had she taken reasonable care in ascertaining the truth) or innocent (the party did not breach a duty of care by failing to ascertain the truth).

Mistake. An error concerning a fact existing at the time of contracting. If the mistake relates to a common, shared assumption of the parties it is **mutual**, but if the error concerns a fact that is a basic assumption of only one of the parties, it is **unilateral.**

Mitigation of damages. The avoidance or reduction of loss following a breach of contract.

Moral obligation. *See* Material benefit rule.

Mutual mistake. *See* Mistake.

Mutuality of obligation. When consideration consists of the exchange of promises, the commitment on both sides must be real and meaningful. If the apparent promise of one of the parties is illusory—so qualified or discretionary as to be no commitment at all—that party's apparent promise does not bind him. Because only the other is bound, courts sometimes describe the transaction as lacking mutuality of obligation. This is just another way of saying that the person who made the illusory promise has given no consideration, and no valid contract was formed.

Noscitur a sociis. (Latin: "known from its associates.") A rule of interpretation under which the meaning of each individual word in a series is affected by and affects the meaning of the other words in that series.

Novation. A contract under which an existing contractual duty is discharged and a completely new one is substituted. The new contract may add a party who was not a party to the original contract.

Objective. Something is objective if it is presented to the consciousness, rather than subjective—within the consciousness itself. That is, it is external to the mind rather than within it. In contract law, the word is most commonly applied to describe the legal standard for gauging the state of mind—the intent or understanding—of a party. Therefore, the **objective test** of intent is concerned, not with the party's subjective state of mind—what that party actually thinks or believes, but with what the observable, external evidence of her words or conduct indicate her intention to be. In interpreting the manifest and external **objective evidence** of intent, the law does not attempt to enter the mind of the observer, to take his subjective evidence of what he actually understood the intention to be, but evaluates it

objectively by asking what a reasonable person in the position of the observer would understand it to be. *See also* Reasonableness standard; Subjective standard.

Objective value. *See* Subjective value.

Obligor/obligee. An obligor is one who owes an obligation or debt, and an obligee is one to whom it is owed. In a bilateral contract, each party is an obligor with regard to the performance promised by her, and an obligee with regard to the performance that is due to her.

Officious intermeddler. In the context of unjust enrichment, a person who imposes an unsolicited benefit on another in the absence of emergency circumstances that would have justified the conferral of an unrequested benefit.

Option. A promise, legally binding on the offeror, to keep an offer open for a period of time. A valid option eliminates the offeror's usual power to disregard her commitment to keep the offer open and to revoke it at any time before it is accepted.

Output contract. *See* Requirements and output contracts.

Overhead. *See* Fixed costs.

Pacta sunt servanda. (Latin: "agreements must be kept.") This phrase asserts the moral imperative that the law should enforce contractual promises.

Parol evidence. Evidence of alleged terms not included in the written record of agreement, but claimed by one of the parties to have been agreed to orally before or at the time of execution of the written contract, or in a prior writing.

Partial breach. A breach that is not, or has not yet become, significant enough to qualify as a total and material breach. A party who has substantially performed commits a partial breach, but even where performance is not substantial and the breach is potentially material, it is a partial breach if the breaching party is able to avert it by an effective cure.

Partial integration. *See* Integration/integrated writing.

Penalty. A provision in a contract that is designed to impose, or has the effect of imposing, a burden or punishment on a party for breaching, beyond any actual or expected loss that may be suffered by the victim of the breach.

Positivism. A legal philosophy that stresses the primacy of legal rules and considers the courts' principal role as the application of settled rules to the

facts of individual cases.

Precedent. *See* Stare decisis.

Preexisting duty rule. A rule of consideration doctrine that a performance of or promise to perform an existing duty cannot qualify as consideration. Consideration consists of an exchange of legal detriments—each party must relinquish a legal right in exchange for the promise or performance received from the other. Therefore, if a party already has a legal duty to do or refrain from doing something, his promise to do or refrain from that very act is no relinquishment of a right and cannot be a detriment.

Primary authority. *See* Secondary authority.

Promise. An undertaking to act or refrain from acting in a specified way at some future time.

Promisor/promisee. A promisor is one who makes a promise, and a promisee is one to whom a promise is made. In a bilateral contract, each party is both a promisor of the performance she has promised to the other party, and a promisee of the return performance promised to her by the other party. When consideration is in issue, the person whose promise is sought to be enforced (and whose consideration is not in doubt) is referred to as the promisor, and the promisee is the party whose consideration is in question. In the context of a contract for the benefit of a third party, the promisor is the party who is to perform in favor of the beneficiary, and the promisee is the other party to the contract who has called for the performance to be rendered to the beneficiary.

Promissory condition. *See* Condition.

Promissory estoppel. A doctrine, derived from equitable estoppel, under which a court has the discretion to enforce a noncontractual promise made with the intention of inducing reliance, and justifiably relied on by the promisee to her detriment. Depending on the needs of justice, The promise may be enforced fully, or only to the extent necessary to reimburse wasted costs and expenses.

Prospective nonperformance. Words or conduct by a party prior to the due date of performance, or other circumstances arising before that due date, suggesting the likelihood or possibility of breach when the time for performance arrives. Although the signs of possible future breach are not clear and strong enough to be a repudiation, they may suggest the prospect of material breach, and may give the other party reasonable grounds for feeling insecure about receiving the promised performance. If such

insecurity is justified, the insecure party may demand an **adequate assurance of performance**, and if none is given, may treat the failure to furnish adequate assurance as a repudiation.

Punitive or exemplary damages. Damages awarded to a plaintiff that go beyond the amount needed to compensate for loss and are designed to punish the defendant for particularly egregious intentional or reckless behavior. Punitive damages are sometimes called exemplary damages because they make an example of the defendant, thereby creating a disincentive to others to engage in that conduct in the future.

Pure condition. *See* Condition.

Quantum meruit/quantum valebant. Quantum meruit (Latin: "as much as deserved") is the term used to denote the market value of services. Quantum valebant ("as much as they are worth") signifies the market value of goods. Market value is the common means of measuring the value of goods or services either in restitutionary claims or where a contract is based on a reasonable, rather than a specified price.

Quasi. A Latin word meaning "as if." This word, when used to qualify another (such as "quasi-contract") signifies that a legal fiction is being used. Although the doctrine or fact so qualified is not the same as that represented by the qualified word, it is deemed in law to be treated the same for some purposes. (For example, although a quasi-contract is not the same as an actual contract, it is treated like a contract for some purposes.)

Quasi-contract (quasi ex contractu). *See* Implied-in-law contract.

Realism. *See* Legal realism.

Reasonable expectations. A party's expectations about the performance and benefit of a contract, evaluated not on the basis of what the party claims to have actually expected, but on the basis of what she should have expected as a reasonable person. *See also* Reasonableness standard.

Reasonableness standard. A widely used standard of contract law, under which a party is held accountable for the reasonable import of her words and actions. The meaning of a party's words, or her intention, understanding, or conduct is evaluated on the basis of what a reasonable person in her position would have meant, understood, or done. The **reasonable person** is a hypothetical construct, based on a community standard, typically represented by the jury. *See also* Objective.

Reformation. Where, as a result of mistake or error in transcription, a written contract does not correctly reflect the parties' true agreement, the court

may grant the equitable remedy of reformation to correct the writing so that it reflects the actual agreement between the parties.

Reliance damages. Reliance damages are those costs and expenses incurred in reliance on the contract (or, in promissory estoppel, in reliance on the promise) and wasted or not recouped once the contract (or promise) is breached. If the cost or expense is incurred in performing duties required by the contract, it is **direct or essential reliance.** If the cost or expense is incurred for the purpose of enjoying or using a benefit reasonably expected from the contract, it is **incidental reliance.**

Repudiation. *See* Anticipatory repudiation.

Requirements and output contracts. A requirements contract is one in which the quantity of goods to be supplied is left flexible, and will be based on the buyer's requirements for the goods during the contract period. That is, the buyer agrees to buy all its requirements for the goods from the seller during the term of the contract, and the seller agrees to supply whatever the buyer orders. The buyer's discretion to fix quantities may be limited by a stated or customary range of demand, or if not, by an obligation to act reasonably and in good faith. An output contract is similar, but the flexible quantity is based on the seller's production rather than the buyer's requirements. That is, the seller agrees to sell and the buyer agrees to buy the seller's entire output of the goods during the contract period. Again, the seller's discretion to fix production levels may be limited by a stated or customary range, or by an obligation to act reasonably and in good faith.

Rescission. Broadly speaking, rescission is the cancellation of a contract. The word is used in different contexts. It could mean the cancellation of a contract by mutual consent. It is also commonly used to mean the **avoidance** of a contract by one party on grounds such as fraud or mistake. "Rescission" is also used as a synonym for "termination" where the victim of a material and total breach ends the contractual relationship, withholds further performance, and sues for damages.

Restitution. A judicial remedy under which the court grants judgment for the restoration of property (**specific restitution**) or its value (**monetary restitution**) to a party from whom the property was unjustly taken or has been unjustly retained.

Ribbon matching rule. *See* Mirror image rule.

Rolling contract. A contract that is not concluded at the point of purchase

but becomes binding only at some later stage, after the nondrafting party has had the opportunity to review and signify assent to standard terms drafted by the other party.

Scienter. A central element of fraud, consisting of knowledge of the falsity of an assertion combined with an intent to mislead.

Seal. A wax impression or other insignia placed on paper by a person for the purpose of authenticating the document. In earlier law, a contract executed under seal did not require consideration, but this formal means of dispensing with the need for consideration has fallen away in most jurisdictions.

Secondary authority. A law review, textbook, or other commentary on the law that is not a binding source of law, but that may be persuasive to a court. Secondary authority is distinguished from **primary authority**, such as a statute or binding judicial precedent, which must be followed by a court.

Security interest. An interest in property (such as a mortgage), granted by a debtor to a creditor to secure payment of the debt. If the debtor defaults in payment, the creditor is entitled to foreclose on the property and sell it to satisfy the debt.

Security of transactions. The concept that the enforcement of individual contracts—and hence the protection of reliance in individual transactions—creates a broad sense of reliance throughout the economy, which facilitates market activity by promoting general confidence in the reliability of contractual undertakings.

Severability. A term in a contract is said to be severable if it can be removed from the contract or adjusted without significantly impairing the basis and purpose of the contract. *See also* Divisibility.

Sheriff. *See* Execution.

Shrinkwrap. Standard contract terms set out in a document included in the packaging of a product or in software. Because the terms are included with the packaged product or software, they are not likely to come to the attention of the purchaser until after the container is opened or the software is downloaded.

Signature. A mark or symbol, or an electronic means of identification, executed or adopted by a party with the intention of authenticating a writing or other record.

Special damages. In contract law, special damages are consequential losses

that derive from the plaintiff's special circumstances. Because they would not flow as an obvious and natural consequence of the breach, the defendant cannot reasonably foresee them at the time of contracting, and is therefore not liable for them, unless he is informed of the special circumstances at the time of contracting.

Specific performance. An order by the court directing the defendant to render the contractual performance as promised. Specific performance is an equitable remedy, and is the exception rather than the rule, available only where damages are not an adequate remedy.

Stare decisis. (Latin: "The decision stands.") The doctrine of precedent, under which a later court is bound by the earlier decisions of a court of equal or senior rank in the same judicial hierarchy.

Standard terms/standard contract. Standard contract terms are those that are drafted in advance of contracting and are used in many transactions of the same kind. They may be set out in a written contract, in electronic form, or on an invoice, ticket, or other document. A party that enters into many similar transactions usually drafts the standard terms itself, but parties may use standard terms drafted by a nonparty (such as a trade association). A standard contract is a predrafted contract form containing standard terms.

Subjective standard. A test of intent based on what the parties actually understood, rather than on their objectively demonstrated intent—what their words or conduct reasonably indicate their intent to have been. The subjective standard is not used as a general test of intent, which has long been gauged objectively. However, the subjective standard is applied in discrete areas of contract law when a party's good faith is in issue, or her state of mind is otherwise relevant to the resolution of the case. *See also* Objective.

Subjective value. The value of property or services to the recipient personally, as opposed to **objective value**, which is measured by market worth.

Substantial performance. A performance under a contract that, while not fully in compliance with the contract (and therefore a breach), is nevertheless not deficient in a material way. Because the breach is not material, the plaintiff may not use it as a ground for rescinding the contract, but is confined to claiming monetary compensation for the shortfall in performance.

Surety. A person who, at the request of a debtor, enters into an undertaking with the creditor that she will pay the debtor's debt, or otherwise perform the debtor's obligations, if the debtor fails to pay or perform.

Take-or-pay provision. A term in a contract under which the buyer of goods or services commits himself to take a specified minimum quantity, and promises to pay for that minimum quantity whether or not he actually orders it. A take-or-pay provision may be interpreted as a **penalty** and could be unenforceable on that ground.

Tender. An offer of payment or performance by a party who is ready, willing, and able to render it.

Termination of contract. Where a contract has been materially and totally breached, the victim of the breach may terminate (rescind) the contract, bringing the relationship to an end for purposes of any outstanding future performance, and sue for damages for breach. A contract may also terminate as a result of rescission in other circumstances, such as by agreement between the parties, or following mistake, fraud, or other grounds of avoidance. *See also* Rescission.

Third-party beneficiary. A person who is not a party to a contract but on whom the parties intend to confer the benefit of performance together with an independent right to enforce that performance. A party on whom this independent right of enforcement is conferred is called an **intended beneficiary.** If a stranger to the contract fortuitously acquires an incidental benefit from the contract, without any intent of the parties to confer an enforcement right on him, he is merely an **incidental beneficiary** and has no right to sue on the contract.

"Time is of the essence." A phrase that means that performance within the time specified is a material term of the contract, and that any delay will be a total and material breach of contract.

Total breach. A breach of contract that is both material and incurable, entitling the victim to rescind the contract and claim full expectation relief.

Trade usage. *See* Usage.

Transaction costs. The costs incurred in entering a transaction. When a contract has been breached, the transaction costs resulting from the breach include expenses such as the plaintiff's costs in finding a substitute, the breacher's costs in entering the other transaction perceived as more desirable, and the costs to both parties in negotiating a settlement of the plaintiff's claim or in litigating it. To decide if the breach is efficient, these

costs must be deducted from the potential gains flowing from the breach.

UETA. The Uniform Electronic Transactions Act, a uniform model law, promulgated in 1999, and subsequently adopted by most states, to validate electronic signatures and records, and generally, to ensure that general principles of contract formation are applied to electronic transactions. *See also* E-SIGN.

Unconscionable. A concept, derived from equity, but now also applicable in suits at law, under which a court may use its discretion to refuse enforcement of a term or contract that shocks its conscience. In its modern formulation, unconscionability normally consists of both a **procedural** element (unfair bargaining) and a **substantive** element (resulting unfair terms).

Unenforceable. A contract or term is unenforceable if it contains some defect that precludes its **enforcement** by a court. (For example, a contract is unenforceable if it is subject to the statute of frauds, but does not comply with it.) Strictly speaking, an unenforceable contract or term is not a legal nullity, and is not completely **void**. (For example, a contract that is unenforceable for noncompliance with the statute of frauds may be enforced if the defendant does not raise the statute of frauds as a defense.) However, in most cases, this distinction is not practically significant because the end result is that the party relying on the contract or provision will not be able to obtain a remedy for its breach.

Unfair forfeiture. A general principle of justice under which the court has the discretion to temper the enforcement of the injured party's legal rights to avoid a disproportionately harsh impact on the party against whom enforcement is sought.

Unforeseeable/unforeseen. *See* Foreseen/foreseeable.

Unilateral contract. A unilateral contract is one in which only one of the parties has a promise outstanding at the time that the contract is formed. It is distinct from a bilateral contract, in which there are promises due by both parties at the instant of formation. There can be no such thing as a "unilateral" contract as that word may be understood in a lay sense—a person cannot contract with himself, and a one-sided promise to another person does not qualify as a contract because it lacks consideration. In contract law "unilateral contract" is a term of art, used to describe a situation in which an offer prescribes or permits the act of acceptance to be the offeree's rendition of the very performance that will constitute the

offeree’s consideration under the contract. In this way, the act of signifying acceptance is at the same time the act of performance. The effect of this is that at the instance of acceptance, the offeree has completed the performance of his side of the transaction, and the only thing remaining is the offeror’s promise of return performance. *See also* Bilateral contract.

UNIDROIT Principles of International Commercial Contracts. A compilation of general rules and common principles of contract law that are recommended as applicable to transnational commercial contracts.

Unilateral mistake. *See* Mistake.

United Nations Convention on Contracts for the International Sale of Goods. *See* CISG.

Usage. The customs and established practices in a particular trade, industry, or market.

Ut res magis valeat quam pereat. (Latin: “The thing should rather have effect than be destroyed.”) A rule of interpretation under which a court resolves uncertainty in favor of a meaning that is lawful, reasonable, and congruent with public policy.

Variable costs. *See* Fixed costs.

Vesting. The irrevocable settling of rights on a person.

Void. A contract or term is void if it has no legal effect. It is a legal nullity and cannot be enforced by either party. A void contract must be distinguished from an **avoidable** contract, in which one of the parties has the election either to enforce the contract, or to **rescind** it.

Volunteer. In the context of unjust enrichment, a person who confers a benefit with gratuitous intent.

Waiver. A voluntary abandonment of a legal right.

Windfall. An unexpected and undeserved benefit. In the context of damages, an amount that exceeds what the plaintiff needs to be fully compensated for her loss.

Writ. A written order by a court, requiring or authorizing an act to be performed. A writ of execution or garnishment is an order to the sheriff or equivalent official, requiring her to seize property of the judgment debtor. (*See also* Execution.) In older common law, “writ” was also used to denote the document that commenced an action.

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Contracts

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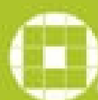

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ELEVENTH EDITION

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CHAPTER 11
CONTRACTS INVOLVING MORE THAN TWO PARTIES

ChapterScope

This chapter considers contracts in which more than two parties are involved. The discussion focuses on multiple parties in two different kinds of contracts: (1) contracts in which a party seeks to ***assign*** his rights to a third person, or to ***delegate*** his duties to a third person; and (2) contracts in which a person who is not an actual party is a ***beneficiary*** of the contract. Key concepts:

- **Assignment:** An ***assignment*** is a ***present transfer*** of a party's already-existing ***rights under a contract.***
  - **Assignable rights:** The general rule (but subject to important exceptions) is that ***contract rights are assignable***.
  - **Rights against obligor:** Generally, the ***assignee takes subject to any defenses*** which could have been asserted by the obligor against the assignor.
- **Delegation:** A ***delegation*** is a present transfer of a party's already existing ***duties*** under a contract.
  - **Delegable duties:** The general rule is that ***contract duties are delegable.*** The exception is that a duty will be non-delegable if the non-delegating party has a substantial interest in having the delegator perform.
  - **Delegator remains liable:** After the delegation, the ***delegator remains liable*** to the obligee.
- **Third party beneficiary:** A person who is not a party to a contract becomes a ***third party beneficiary*** at the time the contract is formed, if the parties to the contract ***intend to confer a benefit*** on that person.
  - **Right to sue:** A third party beneficiary has the ***right to bring suit*** against one of the original parties if the latter does not perform.
  - **Contrast with incidental beneficiary:** By contrast, an ***"incidental"*** beneficiary — one who would be benefited by performance, but upon whom the original parties did not intend to confer a benefit — may ***not*** sue.
  - **Vesting of rights:** The contracting parties' power to ***modify or discharge*** the contract ***terminates*** when the third party

beneficiary's rights have ***"vested."*** Vesting occurs when, before the beneficiary receives notice of the modification, the beneficiary either: (1) ***changes her position*** in justifiable reliance on the contract, (2) ***brings suit*** on the contract, or (3) ***manifests assent*** to it.

I. ASSIGNMENT AND DELEGATION GENERALLY

A. Introduction: The following material deals with attempts by a party to an existing contract to ***substitute another*** in her stead. She may wish to do this by transferring to another her own rights in the contract, by appointing another to perform her duties under the contract, or both. The following pages discuss when such a substitution may be made, and what its effects are.

B. Assignment distinguished from delegation: When a party to an existing contract transfers to a third person his ***rights*** under the contract, he has made an ***assignment***. If the existing party appoints a third person to perform his ***duties*** under the contract, he has made a ***delegation.***

1. Distinguished from other kinds of third-party relationships: Assignments and delegations are attempts to create rights or duties in a third person ***after*** the contract has been executed. They should therefore be distinguished from ***third party beneficiary*** contracts (discussed *infra*, p. 415), in which the rights of a third party are contemplated at the time the contract is made.

a. Distinguished from novation: Assignment and delegation should also be distinguished from a ***novation***, by which ***both*** the existing parties agree that a third party shall take the place of one of them. Assignment and/or delegation can generally occur at the will of one party, whereas a novation requires the consent of both original parties. Also, whereas one who delegates his duties ***remains liable*** if the delegate does not perform, a party who is released by a novation is ***completely discharged*** from all liability. (See the discussion of novation, *infra*, p. 408.)

II. ASSIGNMENT

A. Present transfer: An assignment is a ***present*** transfer of one's rights

under a contract. That is, it is a completely executed transfer, in the same way that a gift is an executed transfer. Therefore, a promise to transfer one's rights in the future is not an assignment, although it may be a contract.

1. **Significance of distinction:** The chief significance of the fact that an assignment is a present transfer is that ***no consideration is required*** for it. For instance, a party who is owed money under an existing contract may assign it to a third person gratuitously, and neither the assignor nor the original obligor will be able to avoid the assignment on the grounds that there was no consideration for it.

B. Assignor's right extinguished: When a valid assignment occurs, the assignor's rights under the contract are ***extinguished*** and may thereafter be exercised only by the assignee. There are some instances, however, in which a valid assignment may be ***revoked*** by the assignor; these instances are discussed *infra*, p. 388. But if the assignment is irrevocable, the ***assignee***, ***not the assignor***, is the ***only one who can enforce the contract rights involved.***

> **Example:** Seller has contracted to supply 1,000 widgets to Buyer for a fixed price. X, sensing that the price of widgets will increase, pays Buyer $100, for which Buyer assigns to X all of his rights under the contract with Seller. This assignment extinguishes Buyer's rights under the contract. If Seller fails to deliver the widgets, only X, and not Buyer, can sue.

C. UCC rules on assignment: Thus far in this book the only part of the UCC which we have encountered is Article 2, dealing with sales of goods. In the case of assignments, however, another part of the UCC is of great importance: Article 9. Even more significantly, Article 9 applies to certain assignments ***even in some situations not involving goods***. Article 9 lays down rules concerning such matters as whether an assignment must be in writing; when a clause in the contract prohibiting assignment is effective; whether the original obligor may assert against the assignee a defense which he could have asserted against the assignor; and perhaps most importantly, how the rights of multiple assignees under the same contract are to be determined.

1. **What assignments are covered by Article 9:** Article 9 does not cover every kind of assignment. The basic purpose of Article 9 is to regulate various aspects of ***commercial financing***, including the

giving of personal property as collateral to secure indebtedness. Because businesspeople who need to obtain working capital often put up as collateral their right to receive payment in the future from contracts which they have or will perform, most assignments of the right to receive payment under a contract (whether the contract is for goods or services) are covered by Article 9. Such an assignment is called a ***"security interest."*** A complete discussion of what kinds of assignments fall within Article 9 is beyond the scope of this outline; however, here are some of the key points:

a. **Assignment of the right to receive payment only:** Article 9 only applies to assignments of the ***right to receive payment***, not the right to receive some other kind of performance. Thus if an inventor has contracted to produce a machine for a corporation, and the corporation assigns its rights to the machine to a third person, the assignment is not covered by Article 9, since it is not the assignment of the right to receive payment.

b. **Wage assignments exempted:** Article 9 does not apply to an employee's assignment of his right to receive ***future wages***.

c. **Sale of a business:** If an assignment is made in connection with the ***sale of a business*** from which the rights assigned arose, Article 9 does not apply.

d. **Where assignee is also delegate:** If the assignee is also to ***perform*** under the contract (i.e., be both assignee and delegate), Article 9 does not apply. See § 9-109(d) for all of the above exceptions and others.

2. **Where Article 9 does apply:** Here is an illustration of the most common kind of situation in which an assignment is governed by Article 9.

> **Example:** Cleaning Co. runs a cleaning service for numerous industrial clients. It has a contract with each of its customers for a one-year period, January-December, 2011. Payment is to be made quarterly. Cleaning Co. is short on cash, so it assigns its rights to payment under each of these contracts to Bank, in return for a cash advance of 90% of the value of the payment rights. This assignment, whether it covers sums that have already been earned by Cleaning Co., sums that it will earn during the rest of the contract, or both, is covered by Article 9 of the UCC. Article 9 imposes the requirement that the assignment be in ***writing***, negates any provision in the original contract which ***purports to prohibit assignment***, and defines Bank's

rights against Cleaning Co.'s creditors.

Note: Where an assignment is made of rights under a contract for a sale of goods, Article 2 of the Code is also relevant. Article 2's provisions on assignment, most of which relate to what kinds of contracts are assignable, include not only the assignment of the right to payment of money (which is the only kind of assignment that Article 9 covers), but also the assignment of rights to performance. A buyer who assigned his right to purchase goods under a sales contract would, for instance, be covered by the relevant provisions of Article 2, which are discussed below.

D. No writing required absent statute: Except in those kinds of assignments that are governed by statutes, an assignment of contract rights does ***not have to be in writing***. See Rest. 2d, § 324.

1. **Assignment of real estate contracts:** Most states have statutes providing that the assignment of a contract interest in ***real estate*** is not effective either against the assignor or the obligor unless there has been a writing.

2. **Assignments covered by Article 9:** Recall that certain assignments of contract rights are governed by Article 9 of the UCC. If a particular assignment is covered by Article 9, it is generally ***not enforceable*** against either the assignor or the original obligor unless the assignor has signed a document called a ***"security interest."*** See § 9-203(b)(3)(A).

E. Gratuitous assignments: A party to a contract may wish to assign his rights under it to some third party without receiving anything in return. Such an assignment, which is in the nature of a gift, is generally called a ***gratuitous assignment***. A gratuitous assignment is generally enforceable, but may under certain circumstances, discussed below, be revoked.

1. **Obligor has no defense:** The obligor who must make the performance may ***not*** refuse to perform on the ground that the assignee ***did not give consideration*** for the assignment.

   Example: *A* owes *B* $1,000. *B* gratuitously assigns his right to this $1,000 to *C*. *A* must make the payment to *C*, and cannot assert as a defense that *C* did not give *B* any consideration.

2. **Revocation:** Although a gratuitous assignment is effective, it will be automatically ***revoked*** if the assignor does any of the following three things:

[1] The assignor ***dies***;

[2] The assignor makes a ***subsequent assignment*** of the same right to a different person; or

[3] The assignor gives ***notice*** to ***either the assignee or the obligor*** that the assignment has been revoked.

See Rest. 2d, § 332(2).

a. Notice to the obligor: Option (3) above — ***notice of revocatio***n given by the assignor either to the assignee or the obligor — means that a revocation of the gratuitous assignment can occur ***without the assignee's even knowing about it.*** So if the assignor tells the obligor to render performance to the assignor rather than to the assignee, this will act as a revocation, and the obligor must do what the assignor says.

Example: On April 1, Uncle orally says to Niece, "Debtor owes me $1,000, due next Jan. 1. I'll instruct Debtor to pay you instead of me." Uncle then so instructs Debtor. On Dec. 1, Uncle says to Debtor, "I've changed my mind because I'm angry at Niece. Pay me instead of Niece." This statement acts to revoke the assignment to Niece (since the assignment was gratuitous). Therefore, if Debtor obeys the instruction and pays Uncle, Niece has no claim against either Uncle or Debtor. That's true even though neither Debtor nor Uncle gave notice to Niece of the revocation.

Furthermore, if Debtor disobeys the instruction and pays Niece, Uncle can sue Debtor for the $1,000 — Debtor's payment to Niece won't serve as a valid defense.

3. How gratuitous assignments may become irrevocable: There are some situations in which a gratuitous assignment is, or becomes, ***irrevocable***. The most important of these are as follows:

a. Delivery of symbolic document: If the contract right being assigned is evidenced by a document that commonly ***symbolizes*** the right, delivery of the document to the assignee makes the assignment irrevocable. See Rest. 2d, § 332(1)(b). Thus if the owner of an ***insurance policy*** delivers it to a third person with appropriate words of assignment, the right to the proceeds becomes irrevocable; the same would be true of delivery of a ***savings bank book*** or of ***shares of stock***.

Example: Insured, who owns an insurance policy on his own life, delivers the policy to Friend, with the words, "I am assigning you this policy." At that moment, the assignment becomes irrevocable, even though it was gratuitous.

b. Writing by assignor: If the assignor himself puts the assignment ***in writing***, most courts (and the Second Restatement — see § 332(1)(a)) hold that the assignment is irrevocable if the ***writing is delivered*** to the assignee. Thus a buyer under a sales contract who delivers a signed writing to a third person assigning his rights under the sales contract has made an irrevocable assignment.

c. Reliance: If the assignee ***relies to his detriment*** on the assignment, and this reliance is reasonably foreseeable by the assignor, the assignment becomes irrevocable. See Rest. 2d, § 332(4).

d. Obligor's performance: If the obligor ***gives the assignee the payment*** or other performance the right to which has been assigned, the assignment becomes irrevocable. Rest. 2d, § 332(3)(a).

> **Example:** Assume the basic facts of the Uncle/Niece example above. Suppose Debtor pays the $1,000 to Niece early, on November 15, before Uncle tells him to pay Uncle instead of Niece. That payment will cause the assignment to become irrevocable, so that Uncle no longer has the power to revoke the assignment by instructing Debtor to pay him directly.

F. What rights are assignable: ***All*** contract rights are by default ***assignable***. That is, an assignment is automatically valid unless it falls within a small number of exceptions, which we discuss below.

1. Rationale: The assignability of contract rights facilitates the financing of businesses, and makes commerce efficient in other ways as well.

2. Exceptions: However, there are a few ***exceptions*** to this general rule of assignability. the Second Restatement (§ 317(2)) lists three kinds of situations in which the general policy favoring assignability is outweighed by considerations of fairness to the parties, or other specific factors:

[1] **Damage to obligor's interests:** The substitution of the assignee for the assignor "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 chances of obtaining return performance***, or materially ***reduce its value*** to him." (See Pars. 3-5 below.) (See also UCC § 2-210(2), containing similar language.)

[2] **Forbidden by statute:** The assignment is ***forbidden by statute*** or is "otherwise against public policy." (See Par. 8 on p. 393.)

[3] **Anti-assignment clause:** The assignment is precluded by a valid and enforceable ***anti-assignment clause*** in the contract. (See Par. G on p. 393.)

3. Assignments that would materially alter the obligor's duty: Since an assignment requires the obligor to render his performance to the assignee rather than to the assignor, the obligor's duty is always changed somewhat by the assignment. But it is only where the obligor's duty would be changed ***materially*** that assignment will be disallowed by the court.

a. Personal service contracts: If the contract requires a party to perform ***personal services*** for a particular employer, the employer may assign his right to receive those services if (and only if) there is ***no special relationship*** of ***trust*** or ***confidence*** between the parties, or any other factor which would render an assignment a ***materially greater burden*** to the party performing the services.

Example 1 (not assignable): Star, a movie star, hires Secretary for a below-market wage, which Secretary agrees to take because she wants to work closely with Star. Star cannot unilaterally assign the contract to Friend, thus requiring Secretary to work for Friend for the same wages, because the assignment would materially alter Secretary's duties. (It would also materially reduce the contract's value to Secretary, a factor that by itself will prevent assignability.)

Example 2 (assignable): D is a newscaster-anchorman for D.C. Channel Nine, owned by Post-Newsweek. After he has worked for one year of a three-year contract, the station is sold to P, and D's contract is assigned to P. A year after the sale, D goes to work for a competing station. P sues for an injunction. D defends on the grounds that the assignment was void because D had had a close, "almost family" relationship with the Post-Newsweek executives, who no longer work for the station following the sale.

Held, for P. The services required of D following the sale were substantially the same as prior to it (e.g., he anchored the same news programs, was given the same number of special assignments, etc.) Nor did the contract guarantee D that he would work under the supervision of particular employees; rather, the corporation's duty under the contract was essentially to compensate D. Therefore, the contract was assignable, and P is entitled to the injunction. *Evening News Ass'n v. Peterson*, 477 F. Supp. 77 (D.D.C. 1979).

Caveat: Keep in mind that in a personal services contract, the restrictions mentioned above apply only where it is the person who is to ***receive*** the personal services who tries to assign his rights. The person who is to render the services, in

return for money, ***may normally assign his right to payment*** (unless prevented by an anti-wage-assignment statute).

b. "Requirements" and "output" contracts: Before the UCC was adopted, it was generally held that ***"requirements"*** and ***"output"*** contracts (explained *supra*, p. 115) could ***not be assigned*** since the assignee's needs, or his output, would be different from those of the assignor.

i. **UCC may allow assignment:** But the UCC appears to permit assignments of requirements and output contracts, at least if the assignee's output or requirements are ***not "unreasonably disproportionate"*** to the assignor's estimated output or requirements. See § 2-306(1) (imposing a general rule of good faith and reasonable quantity in such contracts) and Comment 4 to § 2-210 (stating that the "unreasonably disproportionate" test removes the "personal discretion" element, thus making assignments possible).

4. Assignments that would materially vary the risk: Just as an assignment will not be allowed if it will materially change the obligor's duty, assignment will not be allowed if it will materially ***vary the risk*** assumed by the obligor. This is the case even though the risk is merely different, not necessarily increased. C&P, pp. 681-82. The most common example of an assignment which would run afoul of this rule is an ***insurance policy***.

Example: Driver takes out a collision insurance policy on his 2012 Mustang. He then sells the car to Buyer, and attempts to assign the collision policy to him. The assignment is ineffective, since it materially varies the risk assumed by the insurance company. Although the property still has approximately the same value, the premium was presumably pegged in part to the past driving record of Driver, and Buyer's driving record is not necessarily the same.

5. Assignments that would materially impair the obligor's chance to obtain return performance: Both the Second Restatement (§ 317(2)(a)), and the UCC (§ 2-210(2)), prohibit an assignment which would ***"impair materially [the obligor's] chances of obtaining return performance."***

a. How impairment might happen: Since an assignment is the transfer of the assignor's ***rights***, not his duties, an assignment by

itself (i.e., not accompanied by a delegation of the assignor's duties) will usually not impair the obligor's chance to get return performance. But such a situation can still arise, as in the following example.

Example: Brenda, a famous fashion designer, contracts to have Manco custom-manufacture certain dresses that Brenda says she will sell under her own name for $2,000 apiece. Brenda has agreed to pay Manco $500 each for the dresses. Payment is due 60 days after delivery. The contract is silent about assignability. Manco has agreed to a relatively low price (given the work involved) because it wants to be able to advertise in the trade that it makes dresses for the famous and prestigious Brenda. Before Manco starts work, Brenda assigns her rights under the contract to Schlock, a mass-market designer of goods that are widely regarded as of low quality.

A court might well hold that this assignment is void, on the grounds that it would "increase materially the burden or risk imposed on [Manco] by his contract, or impair materially his chance of obtaining return performance" (the standard for non-assignability under UCC § 2-210(2)). That's because, even though Brenda remains liable for payment, a meaningful part of the "return performance" anticipated by Manco — being able to say that Brenda sells clothes he makes — has been taken from him.

6. **Assignment by seller of right to payment:** On the other hand, there's one big area in which assignment is ***automatically allowed***. That's the assignment by a seller of her ***right to payment.*** Remember that UCC § 2-210(2) says that assignment is not allowed where it 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." But the phrase leading in to this clause says that it applies "except as otherwise provided in Section 9-406." § 9-406 in turn says, in sub-section (d), that a seller or other person who is owed money is normally (i.e., with some exceptions not relevant here) ***permitted to assign that right to payment*** even if the contract between seller and buyer says that assignment is ***prohibited***. And that's true even if, on the facts, the buyer has reasonable concerns that her chances of getting return performance will be impaired by the assignment.

Example: Same basic fact pattern as the Brenda-Manco example above. Now, assume that: (1) the contract says that Manco may not assign its right to payment for the dresses to anyone, and that any such assignment will be void; (2) Brenda doesn't assign her right to the dresses, furnishes the specs for them herself, and plans to take delivery herself; (3) Manco is in debt, so in advance of making the dresses he assigns his future right to payment for them to Factor, a creditor. Even

before Manco starts production, Brenda discovers that Manco has assigned payment. Brenda (reasonably) fears that Manco now won't have an incentive to do good and timely manufacturing, because he won't get any fresh money for completing the contract. Brenda would therefore like to declare Manco in breach of contract because of the assignment, cancel the contract, and give it to someone else. But § 9-406(d) prevents her from doing this. Brenda is what § 9-406(d) calls an "account debtor," and § 9-406(d) says that the assignment of the "account" (the right to receive payment from Brenda) by Manco to Factor is *effective* even though prohibited in the contract between the assignor (Manco) and the account debtor (Brenda).

The purpose of § 9-406(d) is to permit sellers to make untrammelled use of the modern technique of "factoring" (the sale of receivables) and other financing techniques (e.g., creation of security interests in receivables).

a. **Creation of security interest can't be prohibited:** As you probably would expect, since § 9-406(d) prevents the parties from agreeing to prohibit the seller from assigning his right to payment, that section also prevents the parties from agreeing that the seller won't take the less-drastic step of creating a ***security interest*** in the receivable. (See *supra*, p. 387 for a definition of "security interest.") See § 2-210(3), which says that "The creation, attachment, perfection, or enforcement of a ***security interest*** in the seller's interest under a contract is ***not a transfer that materially changes the duty of or increases materially the burden or risk*** imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2)" (unless actual foreclosure of the security interest occurs, and even then the security interest will still be enforceable).

Example: So on the above example, if Manco, instead of "selling" the receivable to Factor, gave Factor a security interest in the receivable to ensure repayment, this security interest, too, would be enforceable under §§ 9-406(d) and 2-210(3), notwithstanding the attempt in the Brenda-Manco contract to prohibit it.

7. **Assignment coupled with delegation:** In many instances, an assignment of rights is coupled with a ***delegation*** of duties. When this occurs, the assignment will not be valid if the delegation is not also valid. (The validity of delegations is discussed *infra*, p. 407.)

a. **UCC allows demand for assurances:** Where an assignment is coupled with a delegation, and the underlying contract is one for the sale of goods, the UCC permits the obligor to "treat any assignment which delegates performance as creating reasonable

grounds for insecurity" and allows him to "demand assurances from the assignee." (§ 2-210(5)). The assignee must render such assurances, or be held to have repudiated the contract. (§ 2-609.) The obligor may make such a demand for assurances even where the delegation would itself be permissible.

8. **Assignments forbidden by statute and "public policy":** Statutes in many states forbid the assignment of certain kinds of contract rights. The most common example is statutes prohibiting the assignment of ***wages***. "Public policy" is also interpreted in many states to prohibit many kinds of assignments; the assignment of the right to ***alimony payments which have not yet become due***, and the assignment of ***tort claims to lawyers*** for purposes of litigating them, are examples. C&P, pp. 683-84.

G. **Contract terms prohibiting assignment:** Parties to a contract often stipulate in the document itself that rights under the contract may not be assigned. The stipulation may say something like "No rights under this contract may be assigned," or a clumsier formulation may be used, e.g., "This contract may not be assigned." Courts have become increasingly less willing to honor such non-assignment provisions. Here, we'll discuss how the Second Restatement and the UCC handle such anti-assignment clauses.

1. **Second Restatement view:** The Second Restatement starts with the general rule that ***a clause in the contract prohibiting the assignment of rights under it will be effective***. Rest. 2d, § 322. It then carves out a series of exceptions to and rules of construction for such anti-assignment clauses. Here are some:

a. **Where assignor has fully performed:** If the assignor has already ***fully performed*** all of his obligations under the contract, she may assign her rights under that contract despite an anti-assignment clause. This rule has its most frequent application where the assignor has earned the ***right to payment*** for work which she has already completed under the contract.

b. **Violation gives right to damages for breach:** An assignment made in violation of an applicable anti-assignment clause does ***not render the assignment ineffective***, but does give the obligor a right

to ***damages*** against the assignor for breach of the clause. Thus ***the assignee may compel the obligor to perform***, but any losses the obligor suffers from the assignment he may recover from the assignor.

c. **For benefit of obligor:** An anti-assignment clause is ***for the obligor's benefit***; if she wishes, she can ***waive*** the clause's benefit and render the performance to the assignee as if there were no anti-assignment clause. Furthermore, if the obligor refuses to render performance to the assignee, the assignee may ***sue the assignor as if there were no anti-assignment clause***. (The rights of an assignee against her assignor are discussed *infra*, p. 402.)

d. **Prohibition on assignment of "the contract":** If the anti-assignment clause states that ***"the contract"*** may not be assigned (as opposed to stating that "rights under the contract may not be assigned"), the clause will be interpreted to bar only the ***delegation*** of the assignor's duties, ***not the assignment of his rights.***

e. **All these are rules of construction:** All the above rules laid down by the Restatement are merely ***rules of construction***. That is, the parties are free to change any of these rules if they make their intention to do so perfectly clear. Thus the parties might explicitly agree that the anti-assignment clause forbids even the assignment of the right to damages for total breach, or that any assignment shall be void as against the obligor.

2. **UCC view:** Article 2 of the UCC treats anti-assignment clauses in contracts for the sale of goods in much the same way as the Restatement handles these matters. The parties are given freedom to prohibit assignment, with the following exceptions and qualifications:

   a. **Damages for breach:** As does the Restatement, the UCC (§ 2-210(2)) permits a party who has a claim for total breach (i.e., ***material breach***) to assign his claim even if the contract prohibits such assignment.

   b. **Assignor has completely performed:** Again like the Restatement, the UCC permits a buyer or seller who has ***already completely performed*** to assign his rights under the contract even if the

contract purports to prohibit such assignment. (§ 2-210(2); § 9-318(4)).

c. **Assignment of "the contract":** Unless the parties otherwise agree, "a prohibition of assignment of 'the contract' is to be construed as barring only the ***delegation*** to the assignee of the assignor's performance." (§ 2-210(3)).

Note: The first two of the above rules are ***firm statutory commandments***, not rules of construction as they are under the Restatement. Thus no matter how clear a sales contract makes it that the buyer is not to have the right to assign a claim for total breach, or a claim for performance once she has rendered her own performance, she may make such an assignment. The rule construing language prohibiting assignment of "the contract," on the other hand, is a rule of construction, and applies only where the parties have not manifested a contrary understanding of the meaning of the clause.

3. **Article 9's prohibition of anti-assignment clauses:** Recall that Article 9 of the UCC applies to the assignment of rights under certain contracts. See *supra*, p. 387. When a particular assignment falls within Article 9's coverage, the above provisions of Article 2 do not apply, even if the original contract was for the sale of goods. Instead, Article 9 itself provides, in § 9-406(d), that any anti-assignment term in a contract covered by Article 9 is ***ineffective***. For a discussion of how this works, see Par. 4 *supra*, p. 392, and the Brenda-Manco Example following it.

4. **Provision prohibiting assignment without consent:** So far, we have assumed that the contract completely prohibits assignment. Usually, however, the contract says merely that the contract may not be assigned ***"without the consent"*** of the other party. Such clauses are generally ***not construed strictly***:

a. **Consent not to be unreasonably withheld:** Many modern courts hold that such a clause should normally be interpreted as if it contained a further provision that the other party ***will not withhold its consent unreasonably.*** In other words, a "no assignment without consent clause" will be enforced if the assignor fails to seek the other party's approval, or if the other party reasonably objects to the assignment, but will ***not*** be enforced if the other party's refusal to consent is unreasonable or capricious. Farnsworth, p. 718.

b. Prohibited assignment yields damages but is effective: Furthermore, many courts hold that a no-assignment-of-the-contract clause should be "read as imposing a ***duty*** on the assignor not to assign, but [***not*** as] making an assignment ***invalid***." Farnsworth p. 717. In other words, the non-assigning party may sue the assignor for damages for breach, but the assignment is nonetheless ***effective*** to transfer to the assignee the assignor's rights. See Rest. 2d, § 222: "[A] contract term prohibiting assignment of rights under the contract, unless a different intention is manifested ... (b) gives the obligor a right to damages for breach of the terms forbidding assignment ***but does not render the assignment ineffective***."

i. **Parties can say otherwise:** But the preference for an interpretation that imposes a duty not to assign, but that does not prevent the assignment from being effective, can be foreclosed by the parties' own ***explicit language to the contrary.*** That is, the parties are always free to say something like, "Any assignment made without the express written consent of the non-assigning party shall be ***null and void***," and if they do say that, any purported assignment will be ineffective, not just a breach of a promise.

H. Rights of the assignee against the obligor: As a general rule, the assignee ***"stands in the shoes of his assignor."*** That is, with the exceptions noted below, the assignee takes ***subject to all defenses, set-offs, and counterclaims which the obligor could have asserted against the assignor***.

1. Significance: This is the single ***most important rule to remember*** about assignment.

Example: Dealer, a used-car dealer, leases a used 2010 Corvette to Speedster. Shortly after the lease, Dealer assigns to Bank all of Dealer's interest in the lease contract, including of course the right to receive the lease payments from Speedster. The car turns out to have twice as many miles on it as Dealer represented it to have.

If Bank sues Speedster for payment, Speedster will be entitled to assert against Bank any defenses or claims that he could have asserted against Dealer. This includes a counterclaim for breach of express warranty (i.e., that the mileage stated on the odometer was accurate). As we will see below (see p. 399), this defense cannot yield an affirmative recovery for Speedster. But it will serve as a "set off,"

and, if it's large enough, completely wipe out any lease payments that would otherwise be owed by Speedster.

2. **Effect of obligor's giving performance to assignor:** However, in one extremely important respect, the assignee's rights can be ***better*** than the rights of his assignor. Once the obligor has received ***notice*** of the assignment (from either the assignor or the assignee), ***he cannot thereafter pay*** (or otherwise give his performance to) the assignor, and use this defense against the assignee, whereas he could use the payment defense against the assignor. See Rest. 2d, § 336(2). But if the obligor pays the assignor or otherwise gives him the required performance ***before*** he has received notice of the assignment, he ***may*** use this as a defense against the assignee. Cf. *Herzog v. Irace*, 594 A.2d 1106 (Me. 1991).

   a. **UCC provision:** This result has long been part of the common law. But it's also now embedded in the UCC, by means of a provision in Article 9, which applies even in cases ***not involving the sale of goods.*** UCC § 9-406(a) refers to the obligor (the person who owns the money) as being an "account debtor," and says that (subject to a few minor exceptions):

   > "[A]n account debtor ... may discharge its obligation by paying the assignor ***until, but not after,*** the account debtor receives a ***notification*** [signed by] the ***assignor or the assignee,*** that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor ***may*** discharge its obligation by paying the ***assignee*** and may ***not*** discharge the obligation by paying the ***assignor***."

   Example: Painter agrees to paint Owner's house for $10,000. The contract says that Painter can't assign his right to payment. Before doing the work, Painter assigns his right to payment to Bank, to which he owes money. On Feb. 1, Bank notifies Owner of the assignment, and that when the job is complete, Owner is to pay Bank, not Owner. Owner receives this letter, reads it, and then forgets about it. Painter completes the job according to the contract, and sends Owner a bill on March 1. Owner pays the $10,000 to Painter, who does not pass the money on to Bank. Bank sues Owner for the $10,000.

   Bank will win. First, as we saw *supra*, p. 392, the contract language forbidding assignment is ineffective because of the special UCC provision nullifying clauses that forbid assignment of a right to payment. Second, once Owner (the account debtor) received a notification from either the assignor (Painter) or the assignee (Bank), Owner was ***no longer allowed*** to render payment to Painter. When he did so anyway, he was not entitled to claim that payment as a defense in the suit by Bank.

i. **Limitation:** Keep in mind that the giving of notice of the assignment cuts off only defenses based on the *obligor's* payment (or his rendering of any required non-payment performance) to the assignor. If the *assignor fails to perform his duties* under the contract, the obligor may still use this breach as a defense in a suit by the assignee, even if, as will usually be the case, he received notice of the assignment. See Rest. 2d, § 336.

3. **Modification of the contract by obligor and assignor:** Frequently the obligor and the assignor will attempt, after an assignment has been made, to ***modify*** the original contract. Their ability to do so, and by so doing to change the rights of the assignee, depends on whether the modification occurs ***before*** the ***obligor has notice of the assignment,*** and on whether the contract is still at least partly ***executory*** (not yet fully performed) on both sides at the time of assignment.

   a. **Modification made before notice of assignment:** ***Before the obligor has received notice*** of the assignment, he and the assignor are ***completely free to modify the contract.*** However, both the Second Restatement (§ 338(1)) and the UCC (§ 9-405(a)) allow such a modification to affect the assignee's rights only if it is ***"made in good faith."*** (The Restatement adds that the modification must be "in accordance with ***reasonable commercial standards***.")

   Example: Owner signs a contract with Contractor under which Contractor will build an office building on Owner's property, for $1 million. Contractor assigns the right to payment which he will have under the contract to Bank, to obtain financing. Neither Bank nor Contractor notifies Owner at this time about the assignment. Contractor completes the work. Owner has some financial problems, and begs Contractor to lower the contract price to $900,000. Contractor does so, in return for Owner's promise to pay within 30 days. Only after this modification does Bank finally notify Owner of the assignment.

   Assuming that the modification was made "in good faith" and "in accordance with reasonable commercial standards" (which it appears to have been — for instance, Contractor doesn't seem to have been trying to injure Bank for his own gain), the modification will be binding on Bank. This is true even though the modification occurred after Contractor had fully performed. Therefore, Bank can only collect $900,000.

   b. **Modification after notice of assignment has been given:** If notice of assignment has ***already been given*** to the obligor, then he and

the assignor may modify the contract ***only if the assignor has not yet fully performed***. (Again, the modification must be "made in good faith"; UCC §§ 9-405(a), (b).) If the assignor ***has already fully performed*** (and notice of assignment has been given), ***no modification may affect the assignee's rights without his approval.*** Rest. 2d, § 338(2); UCC § 9-405(b).

> **Example:** Same basic facts as the previous example. Now, however, assume that Bank (acting sensibly, this time) gave Owner notice of the assignment as soon as the assignment occurred. Again, assume that Contractor finished the work, and Owner and Contractor then secretly agreed to a 10% price reduction.
>
> This time, the modification (the price reduction) is ***not binding*** on Bank, because: (i) it occurred after Contractor (the assignor) had fully performed; and (ii) it was made without Bank's consent. So Bank's prompt giving of notice of assignment made the difference.

4. **Waiver of defenses by obligor:** Many sale and lease contracts which contemplate the extension of credit to the buyer or lessee contain a ***"waiver of defenses"*** clause. This clause typically provides that the seller or lessor may assign the contract, and that the buyer/lessee ***agrees not to assert any defenses*** against the assignee.

   a. **UCC view:** The UCC generally ***enforces*** waiver-of-defense clauses. § 9-403(b) sets forth the general rule that:

   > "an ***agreement*** between an account debtor and an assignor ***not to assert against an assignee any claim or defense*** that the account debtor may have against the assignor is ***enforceable by an assignee that takes an assignment:*** (1) for value; ***(2) in good faith;*** [and] (4) ***without notice of [the] defense or claim[.]"***

   However, § 9-403 also sets out two very important ***exceptions*** to this general rule:

   i. **"Real" defenses:** First, a waiver-of-defenses clause is ***not effective*** as to "defenses of a type that may be asserted against a holder in due course of a negotiable instrument[.]" § 9-403(c). Some of the more important defenses (called ***"real"*** defenses) that, under this definition, are never waived by the obligor (as opposed to the so-called "personal" defenses which can be waived) are:

      (1) Infancy, incapacity, or duress;

      (2) Illegality of the original contract;

      (3) The obligor's discharge in bankruptcy; and

(4) “***Fraud*** that induced the obligor to sign the [contract] with neither knowledge nor reasonable opportunity to learn of its ***character or its essential terms.***”

See UCC § 3-305(a)(2) for a list of these “real” defenses.

Note: The kind of “fraud” defense that is not waived is that usually called ***“fraud in the essence.”*** The common illustration of this is where a person is tricked into signing a piece of paper in the belief that it is merely a receipt or some other document, not a contract. If, on the other hand, the signer knows that he is signing a contract, but has been induced to sign it because of the other party’s misrepresentations about the product’s quality, the misrepresentation is said to be “fraud in the inducement” and is ***not*** covered by the language quoted above. Such a misrepresentation defense ***is waived*** by a valid “waiver-of-defenses” clause.

ii. **Statutes or decisions involving consumer goods:** Secondly, the rule allowing such a waiver of defenses by a buyer or lessee is expressly made “subject to law other than this article which establishes a different rule for an account debtor who is an ***individual*** and who incurred the obligation primarily for ***personal, family, or household purposes***.” § 9-403(e). Many states have retail installment statutes which make such “waiver-of-defenses” clauses ***unenforceable***. Even more important, a ***Federal Trade Commission Rule*** prohibits ***any retail installment or credit contract from containing a waiver-of-defenses clause.*** See 16 C.F.R. 433.2.

Example: Auto Dealer sells a car to Consumer on credit. Dealer then assigns the contract to Bank. The automobile turns out to be a lemon that breaches the implied warranty of merchantability. As a matter of federal law, Consumer must be permitted to assert against Bank any defenses Consumer could raise against Dealer. This means that Consumer may withhold payments from Bank in an amount equal to the damages suffered by Consumer from the breach of the merchantability warranty.

iii. **Commercial context:** In a ***commercial*** context, waiver-of-defenses clauses are almost always ***enforceable*** under the UCC. See the language of § 9-403(b), quoted *supra*, p. 398. Thus if a business person buys, say, equipment under a contract in which the seller grants him credit, and the seller then assigns the contract to a bank or finance company, the buyer ***will not be able to withhold payments even if the equipment is in breach of warranty.*** See, e.g., *Chemical Bank*

v. Rinden Professional Association, 498 A.2d 706 (N.H. 1985).

5. **Counterclaims, set-offs and recoupment by the obligor:** Suppose the obligor has a claim that is valid against the assignor. May he ***assert this claim*** in a suit by the assignee, in order to diminish the assignee's recovery? In non-UCC cases, state statutes vary. Many states have adopted for non-UCC cases the same rules as those furnished by the UCC, which are as follows:

   a. **Where obligor's claim relates to assigned contract:** If the obligor's claim against the assignor is ***related to the same contract*** that has been assigned to the assignee, the obligor may use this claim ***whether it arose prior to or subsequent to the obligor's receipt of notice of the assignment.*** § 9-404(a)(1). The obligor's claim in this situation, traditionally called a ***"recoupment,"*** may only be used to ***diminish*** the assignee's claim, and ***may not yield an affirmative recovery*** for the obligor.

      Example: Assembler, which is in the business of assembling electronics for customers, agrees to take memory chips and circuit boards owned by Computer Corp. and insert the chips into the boards. The contract calls for assembly of 10,000 boards at $10 apiece. Computer Corp. supplies enough chips to assemble 15,000 boards, in case some of the chips are bad. After the contract is signed, Assembler assigns all of its contract rights (including the right to be paid by Computer Corp.) to Bank, in return for financing. Assembler does the work properly, delivers the completed boards to Computer Corp. and bills Computer Corp. the contracted-for $100,000. However, Assembler does not return the 5,000 extra chips, and instead sells them to a third party. Bank, as assignee of Assembler, demands payment of $100,000, and sues when Computer Corp. does not pay. Assume that the value of the missing chips is $60,000. Is Computer Corp. entitled to set off the $60,000 against the $100,000 owed to Bank, so that any recovery by Bank will be limited to $40,000?

      The answer is "yes." UCC § 9-404(a)(1) incorporates the common-law rule that an assignee of contract rights (Bank) "stands in the shoes of the assignor," and has no greater rights against the obligor (Computer Corp.) than the assignor (Assembler) had. Since Computer Corp. (obligor) would have been able to assert the missing-chip claim against Assembler (assignor), it may assert that claim as a recoupment against Bank (assignee). This right is dependent upon the fact that Computer Corp.'s claim arises out of the *same contract* as the contract right which Assembler has assigned to Bank. (For how such a case would come out if the claims related to different contracts, see the discussion in Par. (b) below.)

      Note: Keep in mind that the obligor's claim may only be used as a ***"recoupment,"*** (i.e., a defense), not as a true counterclaim. That is, the obligor's claim ***may not***

yield an affirmative recovery (see Par. (c) below). Therefore, if the value of the missing chips was $150,000, Computer Corp. could reduce Bank's recovery to $0, but could not obtain an affirmative judgment against Bank for the remaining $50,000 — instead, it would have to sue Assembler for that $50,000.

b. Obligor's claim unrelated to assigned contract: If the obligor's claim against the assignor ***does not arise out of the contract*** which has been assigned, the obligor may assert this claim against the assignee ***only if the claim accrued before the obligor received notice of the assignment.*** Such a claim is traditionally called a ***"set-off,"*** and, like the recoupment, ***may not yield an affirmative recovery***. § 9-404(a)(2).

Example: Builder makes a contract with Owner (call it "Contract 1") in July, 2010 to renovate Owner's kitchen for $100,000. In August, 2010, Builder and Owner make a separate agreement (call it "Contract 2") for Builder to add a bedroom to Owner's house. In November, 2010, Builder assigns its right to receive payment under Contract 1 to Bank in return for a loan, and that same month notifies Owner of the assignment. In December, 2010, Builder properly completes performance of Contract 1. In January, 2011, Builder breaches Contract 2 by doing the bedroom work in a non-conforming way. In June, 2011, at a time when Owner has never paid Bank (or anyone) anything on Contract 1, Bank sues Owner for the $100,000 due under that contract. The issue is, can Owner raise against Bank the defense that Builder breached Contract 2?

The answer is "no," because Owner's claim under Contract 2 did not accrue until January, 2011, which was *after* the November 2010 date on which Owner received notice of the assignment of Builder's Contract 1 rights to Bank. (If Owner's Contract 2 claim had accrued *prior* to Owner's notice of the Contract 1 assignment, then Owner would have a "set off" against Bank based on Owner's Contract 2 claim, but that claim could only reduce the amount Owner owed to Bank, not yield an affirmative recovery.)

c. Counterclaims: The obligor may generally assert a ***counterclaim*** (i.e., a claim which can yield an ***affirmative*** recovery) against the assignee only if the claim relates to a ***transaction directly between the obligor and the assignee***, not a transaction between the obligor and the assignor.

i. **Affirmative recovery where consumer has been totally defrauded:** However, there is a significant though narrow exception to the principle that the obligor may not obtain an affirmative recovery against the assignee if the claim relates to a transaction between the obligor and the assignor: if the obligor/buyer is a ***consumer***, and the assignor/seller has so totally breached that the obligor/buyer would be entitled to

rescind and get restitution of any payments had payments been made to the assignor/seller rather than to the assignee, most courts seem to agreee that the buyer may recover from the assignee payments already made by the obligor/buyer.

Example: Suppose Consumer contracts to buy a car from Dealer, and signs a financing agreement which Dealer assigns to Bank. Consumer writes out a check to Bank for the first two months' payments, then never receives the delivery of the car. Probably Consumer can sue Bank for return of the two months' payments, since Dealer has so totally breached as to justify Consumer in rescinding the contract. The same result might be true if the car was such a total lemon that, under state law, Consumer would be able to rescind.

I. Rights of successive assignees of the same claim: A party who has rights under a contract may try to ***assign*** those rights to ***two different persons.*** Deciding which one of the asssignees owns the rights can be complex.

1. **1st assignment was revocable:** If the first assignment was ***revocable*** at the time of the second assignment (which could only be the case if the first assignment was ***gratuitous*** — see *supra*, p. 388), the ***second assignee has priority***, according to virtually all jurisdictions.

2. **1st assignment was irrevocable; 2d knew about first or didn't give value:** Now, suppose the first assignment was ***irrevocable*** when made (e.g., because the assignee gave consideration for it), and the second assignee either ***knew*** about the first assignment or didn't give value. Here, the ***first assignee takes priority***, again according to virtually all jurisdictions.

3. **Both gave value; 2d did not know of 1st:** The most common situation, however, is that in which ***both assignees gave value***, and the subsequent one did not know about the first. Here, most courts follow the Second Restatement's approach.

   a. **Restatement "four horsemen" rule:** The Second Restatement (§ 342(b)) gives a ***subsequent assignee*** who receives his assignment in ***good faith***, without knowledge or reason to know of the earlier assignment, and who has ***given value*** for it, ***priority*** over an earlier assignee for value, in four situations. For this reason, the Restatement rule is often called the ***"four horsemen"*** rule. The subsequent assignee must have done one of the following ***four***

things in order to take priority over the first:

[1] He must have ***received payment*** or other satisfaction of the obligation; or

[2] He must have ***obtained a judgment*** against the obligor; or

[3] He must have ***obtained a new contract*** from the obligor by novation (defined *infra*, p. 408); or

[4] He must ***possess "a writing*** of a type customarily accepted as a ***symbol or as evidence of the right assigned"*** (e.g., a bank book or insurance policy).

If the second assignee does not do any of these four things, the first assignee takes priority.

b. UCC rules: As we have frequently pointed out, ***Article 9*** of the UCC treats certain assignments as being ***"security interests"*** (see *supra*, p. 387). Where an assignment is treated as such a security interest, the Code allows the assignee to make a ***public filing*** of his interest. This filing system is used to resolve priorities between assignees of the same claim; the assignee who ***files first*** normally has priority, regardless of whether he received his assignment first, or gave notice of assignment to the obligor first.[1] § 9-322(a).

> **Example:** Contractor will soon be owed money by Owner from a large construction project that Contractor is working on. Contractor assigns his interest in the contract (i.e., his right to receive payment) to Bro, Contractor's brother, in return for a tide-me-over loan. Bro does not file a security interest, even though he could. Two months later, Contractor assigns the same contract rights to Bank in return for another loan. Bank files an Article 9 security interest in the appropriate public records. One day later, Bro files.
>
> Bank will win, because with respect to assignments that are for the purpose of financing (i.e., security interests), first-to-file normally wins under UCC Article 9, regardless of other factors.

J. Rights of assignee against assignor: An assignee may find himself frustrated in his attempt to realize on the rights that have been assigned to him. It may turn out that the obligor is unable to perform, or it may turn out that the assignment was of a right which is not assignable, or the assignor may subsequently assign the same right to someone else, in circumstances which give the subsequent assignee priority (*supra*, p. 401). In some, but not all, of these situations, the assignee will be able to recover damages against the ***assignor***.

1. **Gratuitous assignments:** If the assignment was a ***gratuitous*** one, the assignee will find it difficult to recover against his assignor.

   a. **Later voluntary acts of interference by assignor:** If the assignor intentionally ***interferes*** with the assignee's ability to realize the right (as where the assignor himself ***collects*** from the obligor money the right to which was assigned), the assignee may be able to recover damages if he can show that he ***relied to his detriment*** on the assignment. See Rest. 2d, § 332(4). Similarly, if the assignor made a ***subsequent assignment*** in circumstances that gave the later assignee superior rights, the first assignee might also recover damages based on detrimental reliance. In either case, the claim would probably be based on a ***promissory estoppel*** theory.

   b. **No implied warranties:** But the maker of a gratuitous assignment does ***not*** make the ***implied warranties*** that an assignor for value makes (e.g., that the claim is valid and unencumbered, as discussed below). Rest. 2d, § 333(1). So if the assigned claim simply turns out to be invalid, the assignee is out of luck, at least where the assignor did not know or have reason to know of the invalidity.

2. **Assignments made for value:** If the assignment was made for value, the assignor will be held to have made a series of ***implied warranties*** to the assignee. If these warranties turn out not to be accurate, the assignee may sue the assignor for damages for breach of warranty.

   a. **List of warranties:** The warranties which the assignor is held to make are:

      [1] **No impairment:** That the ***assignor*** will do nothing which will ***interfere*** with the enforcement of the obligation by the assignee.

      Example: Assignor implicitly promises that he will ***not assign the claim to someone else*** and that he will ***not attempt to collect the obligation himself*** **from the obligor.**

      [2] **Claim is valid and unencumbered:** That the assigned claim is a ***valid*** one, and that it is not subject to any ***limitations or defenses*** other than those that have been disclosed to the assignee at the time of assignment.

      Example: As security for a bank loan from Bank, Contractor assigns to Bank the

right to receive payment of $10,000 under a completed construction contract with Owner. Contractor impliedly warrants that he knows of no defenses that Owner can plausibly raise that would be good against Bank. But in fact, Contractor knows that Owner is claiming that the work was not done properly, and demanding a $3,000 discount from the $10,000 contract price. By not disclosing this claim to Bank at the time of assignment, Contractor is breaching his implied warranty that the claim is valid and unencumbered.

[3] **Documents are genuine:** That any ***documents*** which are delivered to the assignee that purport to evidence the right are ***genuine***.

Rest. 2d, § 333(1).

b. No warranty of obligor's solvency or willingness to perform: But the assignor does ***not***, however, warrant that the obligor is ***solvent***, or that he will be ***willing or able to perform***. Rest. 2d, § 333(2). Therefore, if the obligor turns out to be unwilling or unable to perform, the assignee has ***no recourse*** against the assignor.

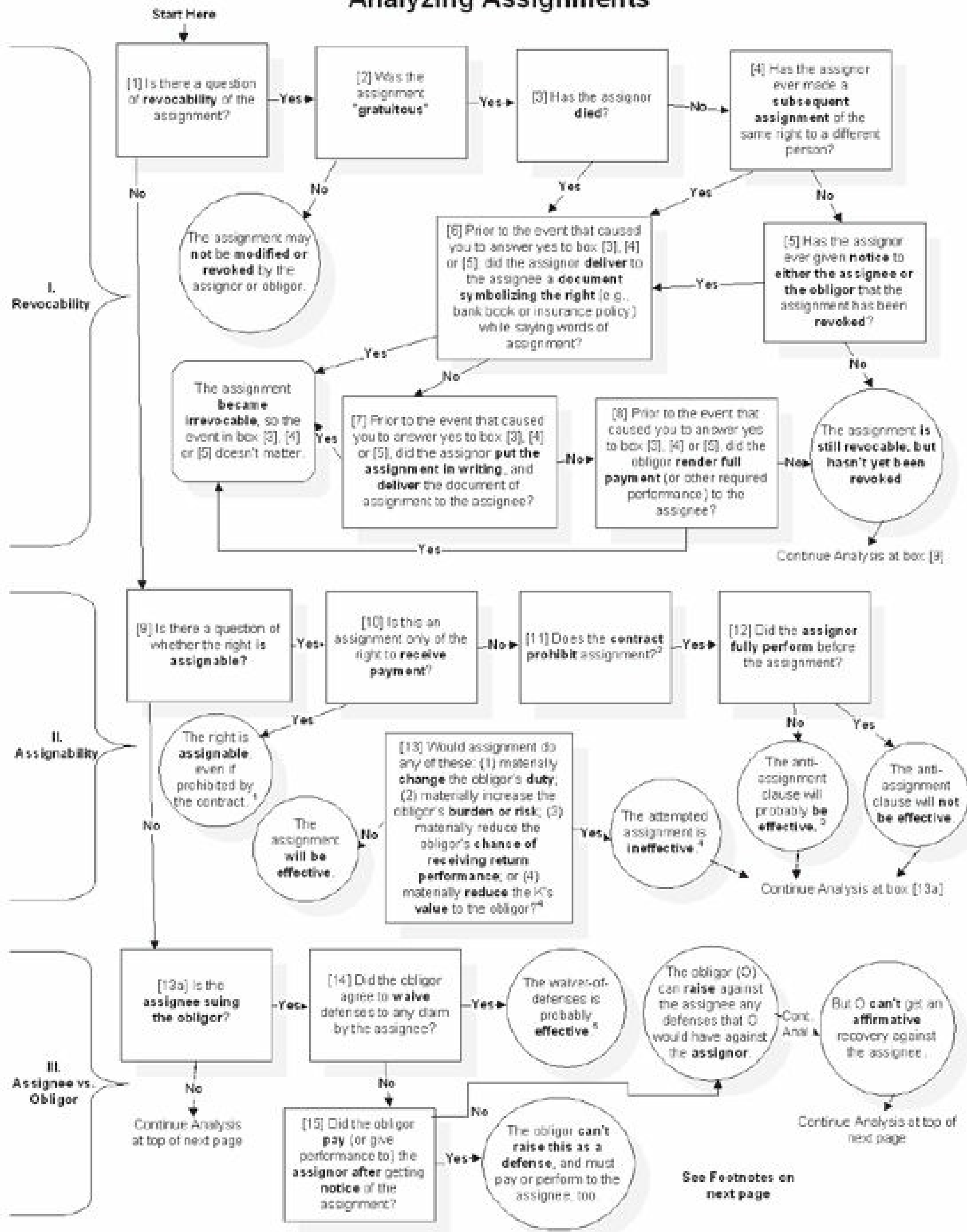
Example: Same basic facts as above example. This time, however, assume that Owner has no complaint about the quality of the work. However, Owner goes broke, and doesn't pay Bank the $10,000. Contractor, by assigning to Bank the right to be paid $10,000, is not deemed to warrant that Owner will actually pay the $10,000. Therefore, Bank has no claim against Contractor when Owner doesn't pay.

i. **Free to agree otherwise:** The assignor may, however, explicitly ***agree*** to guarantee the obligor's performance, in which case the assignee *can* sue her if the obligor fails to perform. ?

3. Sub-assignees not covered: Unless the assignor indicates otherwise, his warranties do ***not*** extend to any ***sub-assignee***, i.e., one who receives the assignment from the assignee. The assignee does, however, make implied warranties to his own sub-assignee along the same lines, and the sub-assignee may sue him for breach of these warranties. Rest. 2d, § 333(4).

Figure 11-1

Analyzing Assignments



Continue Here

IV. Successive Assignees of Same Claim

[16] Are **2 assignees** of the same claim competing? — Yes → [17]; No → [25]

[17] Was the 1st assignment the assignment of the **right to payment**, given as security for a **loan** by the assignee? — Yes → [18]; No → [19]

[18] Did the 1st assignee properly take and **file** a UCC Art. 9 **security interest** before the 2nd assignee did so? — Yes → The 1st assignee wins. No → [19]

[19] Was the 1st assignment **revocable** at the time the 2nd assignment was made? — Yes → The 2nd assignee wins. No → [20]

[20] If you're here, the 1st assignment must have been **irrevocable** (e.g., b/c it was made for **value**) at the time the 2nd assignment was made. — Continue Analysis → [21]

[21] Did the 2nd assignee **know about** the 1st assignment at the time the 2nd assignee took? — Yes → The 1st assignee wins. No → [22]

[22] Did the 2nd assignee **give value**? — No → The 1st assignee wins. Yes → [23]

[23] If you're here, both assignees must have given value, and the 2nd must have taken without notice of the 1st. — Cont. → [24]

[24] Did the 2nd assignee do any of the following: (1) **received payment or** satisfaction from obligor; (2) obtained a **judgment** vs. the obligor; (3) obtained a **new contract** with the obligor by novation; or (4) possessed a **written symbol** of the right (e.g., bank book)? — Yes → The 2nd assignee wins. No → The 1st assignee wins.

V. Assignee vs. Assignor

[25] Is the **assignee** (A'ee) **suing the assignor** (A'or) b/c the obligor didn't perform? — Yes → [26]

[26] Was the assignment **gratuitous**? — Yes → [27]; No → [28]

[27] Did A'or intentionally interfere w/ A'ee's rights after A'ee detrimentally relied? — Yes → A'ee **can** probably recover vs. A'or on **promissory estoppel**. No → A'ee probably **cannot** recover vs. A'or.

[28] A'or **impliedly warrants** that (1) A'or won't interfere; (2) Claim is valid and unencumbered and (3) Docs are genuine. — Cont. Anal. → [29]

[29] But A'or does **not** impliedly warrant that obligor **can or will perform**.[6] — Cont. Anal. → [30]

[30] Did A'or **violate** any of **the warranties** in box [28]? — Yes → A'ee **can recover** vs. A'or for breach of warranty. No → A'ee **cannot** recover vs A'or even though obligor failed to perform.

Notes

[1] UCC §9-406(d) makes any contractual prohibition on the assignment of an "account" (the right to be paid) ineffective. See E II(F)(4).

[2] If the anti-assignment clause says merely that "the contract" may not be assigned, this will normally be interpreted as barring only delegation, not assignment. See E II(G)(1)(d) and (2)(c).

[3] But remember that if all that was assigned was the assignor's right to payment, the anti-assignment clause won't be effective.

[4] Example: A agrees to paint B's house for $1K. B purports to assign to C this right to receive painting, so that A will have to paint C's house (which is bigger). Since A's duty would be materially changed, the assignment is ineffective, and C can't sue A for refusing to paint C's house.

[5] But a waiver-of-defenses is, by federal law, not valid in a consumer credit or installment agreement. See E II(H)(4)(a)(2).

[6] Example: Paint contracts to paint O's house for $10K. Paint assigns the payment right to Cred for a $8K payment. The assignment is silent about what happens if O doesn't pay. If Paint does the work and O doesn't pay Cred, Cred can't recover against Paint.

4. **Rules of construction, not fixed principles:** All of the above rules on warranties are generally common law, rather than statutory. The Second Restatement, § 333, treats them as rules of construction which may be varied by showing a "contrary intention." The UCC does not treat the issue of assignor's warranties, and therefore leaves this area

to the common-law rules.

Quiz Yourself on
ASSIGNMENT

108. Noah Webster sells the movie rights for his dictionary to Sammy Goldfish for $2,000. Webster assigns his right to payment under the contract to his nephew, Spyder, without receiving any compensation from Spyder.

(A) After assigning his payment rights to Spyder, Webster assigns those rights to Webb Foote, a friend, before Spyder has collected anything. Webb Foote knows nothing of the prior assignment to Spyder. Webb Foote does not given any consideration to Webster for the assignment. As between Spyder and Webb, who has superior right to the $2,000?

(B) Same basic facts. Now, however, assume that Webster made the original assignment to Spyder in return for a cash advance of $1,000. He makes a subsequent assignment of the same right (fraudulently) to Webb Foote, in return for another advance, of $500. Webb did not know of the prior assignment to Spyder. Webster is not owed money by anyone else. The $2,000 has not been paid by Goldfish. As between Spyder and Webb, who has priority?

(C) Same facts as part (B). Now, however, assume that at the time of the second assignment (Webster to Webb), Webb knew of the prior assignment to Spyder. Who has priority, Spyder or Webb?

109. Euphrates Faceless claims to have Napoleon's diary in his possession. He sells it to the Liberté Publishing Company in return for royalties, on Euphrates' promise that the diary is genuine. The publishing contract calls for Liberté to make an advance of $50,000 against royalties one month after signing. Euphrates assigns this right to an advance to his nephew, Irving. Euphrates does this as a gift. Before Liberté pays the advance, the company learns that the diary is forged — for one thing, it's written in felt-tip pen — and Euphrates admits to the forgery. Liberté refuses to honor the contract.

(A) Does Irving have a valid contract claim against Liberté?

(B) Does Irving have a valid contract claim against Euphrates?

110. Alcazaba hires Granada to build a house on his estate, Alhambra. Alcazaba agrees to pay $100,000, of which Alcazaba advances Granada $15,000. Granada subsequently assigns its right to payment of the $100,000 under the contract to Moor, and Moor notifies Alcazaba of this assignment. Alcazaba thereafter pays the remaining $85,000 to Granada rather than to Moor. May Moor recover $85,000 from Alcazaba?

Answers

108. (A) Webb Foote. The assignment to Spyder was gratuitous (not made for consideration). A gratuitous assignment is automatically revoked by, inter alia, the assignor's subsequent assignment of the same right to someone else (even if the second assignment is also gratuitous). That second assignment therefore left Webb Foote with the only remaining rights to the assigned money.

(B) Insufficient facts, because we don't know who filed first under Article 9. This is something of a trick question. Where both assignees of the same claim took for value, and the assignment was a financing device, Article 9 normally governs. Therefore, whichever party first files an Article 9 security interest in the public records will win, and the facts don't tell us who did this first. (Normally, before a litigated controversy between the two, at least one would have filed.)

(C) Spyder. Where the first assignee gives value, and the second one knows of the prior assignment, the first assignee has priority. Many courts base this result on an estoppel theory: the second assignee is "estopped" from taking ahead of the first one, because his own knowledge of the prior right would make it unfair for him to have priority.

109. (A) No. The assignee stands in the shoes of his assignor. This means that Irving takes subject to all the defenses, set-offs, and counterclaims which Liberté could have asserted against Euphrates. Here, Euphrates guaranteed that the diary was genuine and then later admitted it was forged. Euphrates' breach of the contract nullifies Liberté's obligation to pay.

(B) Probably not, because the assignment was gratuitous. The maker of a gratuitous assignment does not make an implied warranty of the assigned claim's validity, as the maker of an assignment-for-value does. Therefore, the mere fact that the claim turns out to be invalid won't be enough to allow Irving to recover against Euphrates. However, if Irving can prove that he relied to his detriment on the assignment (e.g., that he charged an expensive vacation in reliance on it), it is conceivable that Irving may be able to recover under a kind of promissory estoppel theory against Euphrates; that is, Irving would claim that the assignment was an implicit promise by Euphrates that Irving would in fact collect the money, and that Irving's reliance was foreseeable and reasonable.

110. Yes. Once an obligor receives notice of an assignment, he pays the assignor at his own risk, since he (the obligor) won't be able to use this payment as a defense in a suit by the assignee. So Alcazaba was very stupid to ignore the notice of assignment and pay Granada, the assignor. (But any payments that Alcazaba made to Granada *before* Alcazaba received notice of the assignment are a defense vis à vis Moor, even if payment occurred after the assignment.)

III. DELEGATION OF DUTIES

A. Delegation generally: Recall that "delegation" refers to ***duties*** under a contract, not to rights. Thus if a party to a contract wishes to have another person perform his duties under that contract, he delegates them.

B. Continued liability of delegator: When a right is assigned, the assignor's interest in that right is normally extinguished. But when the performance of a duty is delegated, ***the delegator remains liable.*** Rest. 2d, § 318(3).

> **Example:** Owner contracts with Contractor for Contractor to paint Owner's house for $10,000. Contractor delegates his duties to Painter. If Painter fails to perform in the manner required by the original Owner-Contractor contract, Owner may sue Contractor for breach, just as if Contractor had improperly performed the work herself.

1. Rationale: As Calamari & Perillo explain the reason for this rule, "[i]f this were not so, every solvent person could obtain freedom from his debts by delegating them to an insolvent." C&P, p. 698.

2. Novation: Of course, the obligee may explicitly agree to accept the

delegate's performance in ***substitution*** for that of the delegator. If he does so, he has given what is called a "***novation***." The novation *does* release the delegator from all liability. In order for there to be a novation, the obligee must expressly agree to ***accept the delegate's performance*** in lieu of that of the delegator, and to ***release*** the delegator; the obligee's mere consent to the delegation is not enough.

C. Non-delegable duties: There are certain kinds of duties which are ***not delegable***, just as certain kinds of rights are not assignable. In general, a duty or performance is delegable unless the obligee has a ***substantial interest in having the delegator perform***. See Rest. 2d, § 318(2).

1. UCC: This principle is codified in UCC § 2-210(1): "A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a ***substantial interest in having his original promisor perform or control the acts required by the contract.***" Courts apply this same basic rule in non-UCC cases, too.

2. Contracts involving particular skills: Contracts which call for the promisor's use of his ***own particular skills*** are normally ***not delegable,*** on the theory that the other party has a substantial interest in having the promisor perform. Thus contracts involving ***artistic performances***, and contracts involving the ***professional services*** of a lawyer or doctor, etc., are not delegable. (See Rest. 2d, § 318, Illustr. 6.)

Example: Client is charged with murder. He signs an engagement letter (a contract) with Lawyer, a solo practitioner who specializes in white-collar criminal defense work, under which Lawyer will represent him at the trial for a fixed fee of $30,000. The contract says nothing about assignment or delegation. One month before trial, Lawyer sends Client an e-mail, "I have decided that you would be better represented by Barrister, my good friend, who is eager to represent you, and I hereby delegate him to do so." Barrister is in fact much more suited than Lawyer to represent Client, because Barrister specializes in murder cases whereas Lawyer has never done one before (as Client knew when he hired Lawyer).

Client need not accept performance from Barrister — the contract calls for personal professional services, and Lawyer's duties under it were therefore not delegable without Client's consent. If Lawyer insists on making the delegation, Client can refuse and hire someone else (and sue Lawyer for breach). Alternatively, Client can accept the proposed delegation, in which case Lawyer will remain liable if Barrister fails to deliver a defense of the quality called for in the contract.

a. Duties of personal supervision: Similarly, contracts in which

there are ***duties of personal supervision*** may not be delegated. Thus an employer may not delegate his duty to supervise his employee, where the employer-employee contract contemplates close personal supervision. C&P, p. 700.

b. Delegation by corporations: In many situations, a corporation will be allowed to delegate its duties to another corporation. But if the original contract was premised on the assumption that ***particular employees*** of the promisor corporation would perform the work, delegation to another corporation with other employees would not be permitted.

i. **Hiring of agent:** But even if the contract contemplates that a corporation who is a party to it will not delegate the work, the corporation may be allowed to engage another corporation as ***its agent***, provided that some supervision is maintained. Alternatively, a promisor corporation might avoid the difficulties of delegating personal services by agreeing to let its employees help the delegate perform.

3. Delegate is a competitor of the obligee: Another situation in which the delegation may be found to be invalid because it conflicts with the obligee's substantial interests is where the proposed delegate is a ***competitor of the obligee***. For instance, suppose that *A* is the exclusive distributor of *B*'s products, and that *A* agrees to use best efforts to distribute the products as widely as possible. If *A* then proposes to delegate its distribution duties to *C*, a direct competitor of *B*, a court might well hold that *B* has a substantial interest in not having its products distributed by its competitor, and that *B* can therefore block the delegation.

Example: Nexxus enters into a contract with Best under which Best becomes the exclusive distributor of Nexxus' hair care products for the state of Texas. Best implicitly (by operation of the UCC's provisions on exclusive distributorships) agrees to use its "best efforts" to distribute the Nexxus products as widely as possible in Texas. Best is later acquired by and merged into Sally Beauty, a wholly-owned subsidiary of one of Nexxus' biggest competitors, Alberto-Culver. Nexxus, upset at having its exclusive distributorship in effect fall into the hands of a competitor, refuses to continue the distributorship, on the grounds that the merger was an impermissible delegation. Sally sues Nexxus for breach.

Held, for Nexxus. "[T]he 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." Nexxus was entitled to Best's "best efforts," and it was reasonable for Nexxus to think that having those efforts rendered by Nexxus' direct competitor was "a different thing than what it had bargained for." Therefore, the delegation ran afoul of UCC § 2-210(1), under which an unconsented-to delegation is not allowed if the other party has "a substantial interest in having his original promisor perform or control the acts required by the contract."

(A dissenter, Judge Posner, criticized the majority's holding. He argued that Sally [and its parent, Alberto Culver] would have no incentive to lessen its efforts on behalf on Nexxus' products, because the likely damage to Sally's value as a distributorship would outweigh any possible advantage from increased sales of Alberto Culver products. Therefore, the possibility of damage to Nexxus, he said, was too speculative to render the delegation an impermissible interference with Nexxus' interests.) *Sally Beauty Co., Inc. v. Nexxus Products Co.,* 801 F.2d 1001 (7th Cir. 1986).

Note: Judge Posner's dissent in *Sally Beauty* is a good example of the approach of the law-and-economics school's (*supra*, p. 2) approach to Contracts. Law-and-economics proponents often analyze the parties' own economic interests to see how they are likely to behave — that's what Judge Posner did here, leading him to conclude that the assignee (Alberto Culver), even though it was a competitor of the plaintiff, probably wouldn't have induced its subsidiary (Sally) to slack off in distributing P's products.

4. **Preference of other party:** If the performance does *not* require a large degree of taste, discretion, or other particularized skill, it ***will be*** delegable even though the other party has a ***personal preference*** for performance by the named party to the contract.

5. **Delegation of duty of payment:** Since the delegator remains liable after delegation, she may normally delegate the ***duty of payment,*** even if the delegate's credit is not as sound as the delegator's. But if the original contract requires the promisor to execute a promissory note, the promisee will not be required to accept the delegate's promissory note, since such a note would not have the same market value. C&P, p. 761.

6. **Construction and repair contracts:** ***Construction contracts***, and contracts for the ***repair*** of buildings or machinery, ***are*** normally delegable.

   a. **Different intent by parties:** But the rule allowing delegation of such repair or construction contracts is always subject to the understanding of the parties; if the original contract is based on the assumption that the promisor himself will do the constructing or

repairing, delegation will not be allowed.

7. **Agreement of the parties as to delegability:** The parties have almost completely unfettered freedom to decide whether duties under the contract may be delegated. They may agree that ***duties which would otherwise be delegable may not be delegated***, or they may conversely agree to ***allow*** delegation of duties that would normally be thought to be too personal for delegation. This freedom of contract with respect to delegation should be contrasted with the rules on assignment, in which the parties are given less opportunity to make their own rules (*supra*, p. 393).

   a. **UCC rule of construction:** As a rule of ***construction***, the UCC provides that "Unless the circumstances indicate the contrary a prohibition of ***assignment of 'the contract'*** is to be construed as barring only the ***delegation*** to the assignee of the assignor's performance." § 2-210(3). Rest. 2d, § 322(1) is in accord.

D. **The delegate's liability:** A delegation agreement between delegator and delegate may be in one of two forms:

[1] the delegator may simply give the delegate the ***option*** to perform, with the delegate making no promise that he will do so;

[2] the delegate may ***promise*** that he will perform.

In situation [1], the delegate will not have any liability either to the delegator or the obligee if he does not perform. But in situation [2], not only will the delegate be liable to the delegator, he may also be ***liable to the obligee***, who may be a ***third party beneficiary*** of the delegate's promise. Rest. 2d, § 318, Comment b. (For a discussion of third party beneficiaries, see *infra*, p. 415.)

1. **Promise made solely for delegator's benefit:** Sometimes in situation [2], the delegate's language or the surrounding facts will indicate that the delegate intended his promise to be ***only*** for the delegator's, and not the obligee's, benefit. If this is the case, the obligee will not be able to sue the delegate for non-performance. For instance, if the delegate is an ***employee*** of the delegator, or his ***sub-contractor***, courts will normally hold that the delegate's liability runs only to the delegator, and the obligee is nothing more than an "incidental beneficiary of the delegation." C&P, p. 699.

2. **"Assumption":** If a delegate is held to have undertaken liability to

the obligee as well as to the delegator, she is said to have ***assumed*** the delegator's liability.

3. **General " assignment" of the "contract":** A party to a contract sometimes makes an agreement with a third person under which he purports to ***"assign the contract,"*** or uses other such broad general language. By signing such a document, is the assignee held to have promised to perform, thus making him liable to the obligee? Normally, the answer is ***yes***.

That's the approach of the Restatement. Rest. 2d, § 328(1), starts by saying that an assignment of "the contract" or of "all my rights under the contract," or any other similarly general assignment, operates as "an ***assignment*** of the assignor's rights and a ***delegation*** of his unperformed duties under the contract."

§ 328(2) then says that unless the circumstances indicate otherwise, "The acceptance by an assignee of such an assignment operates as a ***promise*** to the assignor to perform the assignor's unperformed duties, and the obligor of the assigned rights is an ***intended beneficiary*** of the promise."

a. **Obligee can sue both:** In other words, the assignee/delegate under such a general assignment clause will normally be held ***liable to both parties*** to the original contract if she fails to perform.

Example: Owner contracts with Contractor for Contractor to paint Owner's house for $10,000. Contractor then signs a document saying he "assigns to Painter my contract to paint Owner's house." Painter accepts the assignment. Under the standard (and Restatement) view, there are three consequences:

(1) Contractor is deemed to have ***delegated*** his duties to Painter (not just assigned his rights, such as the right to payment);

(2) Painter, by accepting the assignment, is deemed to have ***promised*** Contractor that Painter will perform the duties owed by Contractor; and

(3) Owner is an ***intended beneficiary*** of this promise by Painter to Contractor, so if Painter doesn't perform, Owner can sue Painter (as well as Contractor).

Note: **Never forget that when a delegation occurs,** *the delegator remains liable to the obligee,* **unless the obligee** *expressly agrees to a novation,* i.e., to release the delegator from its contractual obligation in return for having the delegate on the hook. So in the common fact pattern in which the obligor/assignor merely assigns "the contract" to the delegate, even if the obligee consents to the assignment/delegation the obligor remains liable unless the obligee expressly

agrees to look only to the delegate for performance and liability. Thus in the above example, where Owner didn't agree to a novation, if Painter doesn't perform, Owner can sue Contractor as well as Painter.

b. Sales of land: However, if such a general assignment of "the contract" is made by one who has purchased ***land*** on which he still owes money, or by the holder of a contract to purchase land, the courts frequently hold that the assignee does ***not*** incur liability to the seller of the land. There is no good reason why the rule in land sale contracts should be different from that in other kinds of contracts, except that the land rule may have grown out of the principle that one who purchases land subject to a mortgage is not liable on the mortgage unless he expressly assumes it.

c. UCC view: In contracts for the sale of ***goods***, the UCC applies a rule very similar to the general Restatement rule quoted above. § 2-210(4) states that "An assignment of 'the contract' or of 'all my rights under the contract' or an assignment in similar general terms is an assignment of rights and unless the language or circumstances (as in an assignment for security) indicate the contrary, it is a ***delegation of performance*** of the duties of the assignor and its acceptance by the assignee constitutes a ***promise by him*** to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract."

i. **Assignment for security:** The reference in the quoted UCC language to an ***"assignment for security"*** refers to the fact that where a general assignment is made for purpose of ***giving collateral***, the lender will ***not*** normally be deemed to have undertaken to perform the assignor's duties. Thus if a seller who has signed a contract under which he is to deliver goods for a price assigns his contract rights to a bank to secure a loan, the bank will not be presumed to have undertaken to deliver the goods.

d. Sale of business: This problem of whether an assignment of "the contract" includes a delegation of duties as well as assignment also arises in the context of the ***sale of a business***. Seller typically not only sells the company's assets to Buyer, but also usually assigns any contracts to which Seller is a party.

i. **Assignment of contracts:** If the sale contract provides that Seller "assigns to Buyer all contracts to which Seller is a party," usually Buyer will be found to have ***assumed the obligation to perform*** under those contracts as well, if the sale of the contract does not explicitly deal with this issue. See Rest.2d, § 328(2), discussed further *supra*, p. 411.

ii. **"Continuation of business" theory:** Even if the buyer of the business does not expressly undertake the liabilities, other rules of law (independent of assignment/delegation theory) may make the buyer liable on those obligations. For instance, if the transfer of assets from the selling corporation to the buying corporation is designed to ***defraud*** the seller's creditors, or if the selling and buying corporations are essentially the same corporation with a mere change of name, a court may well find that the buying corporation should be treated as if it had assumed the seller's liabilities. But courts will impose this kind of liability on a buyer who does not expressly assume the seller's debts only in narrow circumstances.

iii. **Summary:** So in general, even where the owner of a business sells all of the assets of the business to a buyer, and the buyer continues the business, the buyer does not have to perform the seller's contractual obligations unless there is found to be an express or implied delegation (as discussed in paragraph (i) above), or one of a number of very narrow special circumstances exists (e.g., fraud on the seller's creditors). On the other hand, if the buyer *is* found to have expressly or implicitly promised the seller that the buyer will perform the seller's obligations, then the other party on those obligations (e.g., a customer who has a contract with the seller) will be treated as an ***intended beneficiary*** who can sue the buyer if the buyer fails to perform. See Farnsworth, pp. 749-750.

E. Delegation of non-delegable duties: If a party to a contract purports to delegate duties which are in fact too personal to be delegated, the promisee has the right to ***refuse to accept performance from the delegate***, and to hold the delegator liable.

1. **Promisee remains silent** But if the promisee ***remains silent*** when he learns of the delegation, he will probably be held to have assented to this substituted performance, and to have lost his right to demand that the delegator perform.

   a. **Delegator remains liable:** However, the promisee ***will usually not by his silence be held to have consented to a novation.*** That is, although he will lose the right to insist that the delegator rather than the delegate perform, if the delegate performs defectively, the promisee may ***sue the delegator for breach***. See Murray, p. 620. In other words, the delegator ***continues to be liable*** if the promisee merely remains silent in the face of the delegation.

Quiz Yourself on
DELEGATION OF DUTIES

111. Madame Gioconda contracts to pay Leonardo da Vinci $10,000 to paint her portrait. Da Vinci delegates his duties under the contract to Picasso. Gioconda shows up at da Vinci's studio for her first sitting for the portrait, and is shocked to find Picasso instead of da Vinci waiting for her. She's familiar with Picasso's work, which is very different from da Vinci's.

     (A) Suppose that Madame Gioconda immediately objects to the switch, and insists that da Vinci do the portrait. da Vinci refuses, claiming that Picasso's work is at least as good. Will Madame G. be in breach if she refuses to let Picasso do the work?

     (B) For this part only, suppose that Madame Gioconda, though upset at the switch, nonetheless sits for her portrait, while Picasso paints it. May Madame G. recover against da Vinci for breach of contract?

112. Robert E. Lee agrees to lend Abe Lincoln $1,000. The loan agreement contemplates that in return for the money, Lincoln will execute a promissory note. Before Lee makes the actual loan or Lincoln signs the note, Lincoln signs a document that says, "I hereby assign to Jefferson Davis my loan agreement with Robert E. Lee, with the intent that Davis be substituted for me as borrower in said loan agreement." Lincoln hands this assignment document to Davis, who indicates his approval by

signing his initials. Davis presents the assignment document, together with Davis' own promissory note, to Lee, and demands the $1,000.

(A) Assume that Lee does not want to go along with the assignment of the contract. Must Lee make the loan to Davis?

(B) For this part only, assume that the original Lee-Lincoln loan agreement does not call on Lincoln to execute a future promissory note. Instead, the loan agreement recites that Lincoln "shall be liable for any advances made by Lee to Lincoln pursuant to this agreement," and provides that Lee will make advances of up to $1,000. Before Lee has made any advances, Lincoln says to Lee, "I've assigned to Davis my right to receive the $1,000, so pay that sum to him." Lee does so. Davis does not sign any agreement with Lee. He does, however (just before receiving the $1,000) receive from Lincoln a document that says, "Lincoln hereby assigns to Davis Lincoln's loan agreement with Lee." Davis initials this document. If Davis does not repay the $1,000 to Lee, may Lee recover this sum from Davis?

(C) Same facts as part (B). Now, assume that Lee makes the loan to Davis, and Davis defaults, because he's broke after the Civil War. May Lee recover the $1,000 from Lincoln?

113. Khufu has Valley King Architects design a pyramid for him. Khufu takes the plans to Cheops General Contractor, and contracts to have Cheops build the pyramid for him. The contract says nothing about whether delegation by Cheops is permitted. Cheops delegates its duties under the contract to Tut General Contractors, a reputable contractor with reasonable experience in projects of this kind.

(A) Suppose Khufu objects to the delegation as soon as he learns of it. Cheops insists that it is permitted to make the delegation, and that Khufu must accept performance from Tut or be in breach. Khufu remains firm. Which, if either, original party (Khufu or Cheops) is in breach?

(B) For purposes of this part only, assume that the original Khufu-Cheops contract contains the following language: "Cheops hereby agrees to personally perform its duties under this agreement, and not to delegate or attempt to delegate those duties." As soon as Khufu learns of the attempted delegation, he objects. Assume that in the absence of the

just-quoted clause, the attempted delegation would be invalid. Cheops refuses to do the work, and insists that its delegation is valid. Which, if either, original party is now in breach?

(C) Same basic facts as (B). Now, however, assume that the Khufu-Cheops contract's only provision relating to assignment or delegation says, "This contract may not be assigned." If Cheops insists on delegating its performance to Tut, and Khufu objects, who is breach, Cheops or Khufu?

Answers

111. (A) No. Duties to be performed under a contract are generally delegable. But where a contract calls for the performance of personal services by a person with particular personal skills, those services normally may not be delegated. Since portrait-painting involves personal skills that vary significantly from one person to another, such services may not be delegated without the consent of the person who is to receive the services. Therefore, Madame Gioconda can refuse to let Picasso paint her portrait and can insist that da Vinci do it. If she refuses to accept Picasso and da Vinci refuses to paint her portrait, he's breached the contract by repudiating it, and she can recover damages from him.

(B) No. If she sits for the portrait, she will be held to have implicitly assented to the delegation. She will thereby have waived her right to complain about the delegation, and must pay the contract price.

112. (A) No. To begin with, a document that purports to assign "the contract" will generally be interpreted as being an attempt at *both* an assignment of rights *and* a delegation of duties. Therefore, Lincoln's execution of the assignment document, and Davis' initialling of it, will constitute both: (1) an assignment by Lincoln to Davis of Lincoln's right to receive the money; and (2) an attempted delegation to Davis of Lincoln's obligation to tender a promissory note in return for the money.

The attempted delegation will be invalid, if Lee objects to it. That's because a duty as to which the promisee has a substantial interest in having only the original promisor perform is non-delegable. A promise that calls for the promisor's use of his own particular, unusual skills

generally falls into this category. This principle is commonly applied to promissory notes: the promisee is not required to accept a promissory note from a different person than the original promisor, because the delegate's creditworthiness will not be the same as the promisor's. Therefore, if Lee objects, he need not accept Davis' promissory note as a substitute for Lincoln's, and he may refuse to lend the money to Davis.

(B) Yes, probably. As noted in the answer to part (A), a document that purports to assign "the contract" will generally be interpreted as being an attempt at both an assignment of rights and a delegation of duties. So Lincoln has, as in part (A), assigned his rights to the loan, and has attempted to delegate his duty (of repayment). Davis, by initialing the assignment document and receiving the money, has implicitly promised Lincoln that Davis will repay Lee. The more interesting question is whether Lee may sue on this promise, since Davis didn't make the promise to Lee, just to Lincoln. The answer is that Lee may sue if he was a ***third party beneficiary*** (a concept discussed later in this chapter) of Davis' promise to Lincoln. A court will probably hold that Lee was an "intended" beneficiary of Davis' promise (since Lincoln wanted Lincoln's repayment obligation to Lee to be discharged); in that case, Lee may sue Davis.

(C) Yes. Unless the promisee expressly indicates his consent to a ***novation*** (a complete substitution of one promisor for another), the mere fact that the promisee consents to an assignment and delegation does not discharge the assignor/delegator from liability. So here, the fact that Lee allowed the "assignment" of the contract (and made the loan to Davis) will not be interpreted as Lee's consent to substituting Davis for Lincoln. Therefore, Lincoln will remain liable, and may be sued if Davis defaults.

113. (A) Khufu, probably. Where the contract is silent, delegation is normally permissible unless either: (1) the promisee has a ***substantial interest*** in having the delegator perform (usually due to the delegator's unusual personal skills); or (2) the surrounding circumstances indicate that the parties both intended that the duty in question not be delegated. The facts indicate that (1) is not satisfied, since we're told that Tut is competent at work of this type, and the promisee's mere preference that the work be done by the promisor is not enough to constitute a

substantial interest in having the work done by the promisor. As to (2), there's nothing in the surrounding facts to indicate that the parties ever thought about delegability, let alone implicitly agreed to forbid it. Therefore, as in most construction contracts, the duty of performance here will probably be found delegable.

(B) Cheops. A contract provision stating that the duties are not delegable will be enforced, even if the duties are ones that would, in the absence of the provision, be delegable. Therefore, Cheops is insisting on doing something that it has no right to do, and that insistence would be a breach (a repudiation).

(C) Cheops. A contract provision that prohibits "assignment of the contract" will, unless the circumstances indicate otherwise, be prohibited as barring the delegation of duties, but not the assignment of rights. (See UCC § 2-210(3), so stating, for sales-of-goods cases.) Here, there are no circumstances indicating otherwise. Therefore, Cheops' attempted delegation will be a breach of the "anti-assignment" clause (but Cheops' assignment of, say, its right to be paid for its work would not be.)

IV. THIRD PARTY BENEFICIARIES

A. Introduction: A party may form a contract the main purpose of which is to benefit not himself, but a third person. Thus *A* and *B* may make a contract in which *B* makes a promise that will benefit *A*, in return for *A*'s promise to give a performance that will benefit *C*, rather than *B*. The contract might provide that *A* will give *C* a sum of money that *B* intends as a gift for *C*. Or, it might provide that *A* will pay a sum to *C* that will satisfy a debt that *B* owes to *C*. In either case, *C* is said to be a ***third party beneficiary*** of the contract between *A* and *B*.

1. Issue is who may sue: If, in the above situation, *A* fails to perform, *B* may of course sue for damages, since he is a party to the contract. The "fighting issue," however, is ***whether C, the third party beneficiary, may sue***. It is with this question that the rest of this chapter will be concerned.

B. Older cases and the First Restatement: Most older cases, and the first Restatement (§ 133(1)), allowed a third party beneficiary to sue only if he was either: (1) a ***"creditor beneficiary"***; or (2) a ***"donee***

***beneficiary*.”**

a. Creditor beneficiary: If performance of a promise would satisfy ***an actual or supposed or asserted duty of the promisee to a third party***, and it does not appear that the promisee intended to make a gift to the third party, then the third party is called a ***“creditor beneficiary.”*** (That is, the third party is a “creditor” of the promisee.) The practical reason for allowing such a creditor beneficiary to sue is that multiple law suits are prevented. That is, there is no danger that the law suit by the third party creditor against the promisee on the original obligation will be followed by a suit by the promisee against the promisor. Instead, the third party can sue the promisor directly.

Example: X owes $300 to P. X then loans $300 to D, in return for D’s promise to pay X’s debt to P the next day. D fails to pay P, and P sues him.

Held, for P. P may recover as a third party beneficiary of the contract between X and D. This is true even though D was not a “trustee” of the money paid by X. “Manifest justice” requires this result. *Lawrence v. Fox*, 20 N.Y. 268 (N.Y. 1869).

b. Donee beneficiary: If the promisee entered the contract for the purpose of conferring a ***gift*** on a third party, the third party is said to be a ***“donee beneficiary,”*** and is given the right to sue the promisor. The principal reason for allowing the donee beneficiary to sue is that if he can’t, no one else as a practical matter can — the promisee’s own damages will ordinarily be nominal. The promisor would thus be let off the hook, and might be unjustly enriched.

Example: X, who is dying, wants to leave her house to her niece, P. X’s present will leaves the house to X’s husband, D. Because X will probably not live long enough for a new will to be drafted, D promises X that if she keeps her will the same, D will leave P enough money in his will to make up to P for not getting the house. After X’s death, D fails to keep his promise in his own will, and after his death P sues his estate for the value of the house.

Held, P may recover as a donee beneficiary of the agreement between X and D. P is the only one damaged by D’s breach of promise. Furthermore, the cases have for a long time enforced promises to take care of the promisee’s spouse or child; this same principle should be applied where, as here, the beneficiary is the promisee’s beloved niece. *Seaver v. Ransom*, 120 N.E. 639 (N.Y. 1918).

C. Second Restatement’s abandonment of the two category structure: Until recently, many courts refused to permit a third party beneficiary to recover unless she fell into either the creditor beneficiary or the donee

beneficiary class. The Second Restatement ***eliminates*** the use of "donee beneficiary" and "creditor beneficiary," because of their "overtones of obsolete doctrinal difficulties…" (Rest. 2d, Introductory Note to Chapter 4.) Many modern courts have followed suit.

1. **"Intended" beneficiaries may recover:** Under this modern/Restatement approach, the third party may recover if she falls into the unified class of ***"intended beneficiaries."*** Otherwise, she is said to be an ***"incidental beneficiary,"*** and may not sue.

2. **Definition of "intended beneficiary":** For a third party to be an "intended beneficiary," it must first of all be the case that giving him the right to sue would be "appropriate to effectuate the ***intentions of the parties***…"(Rest. § 302(1)). If he meets this test, he must furthermore fit into ***one of the two following categories:***

   a. **Payment of money:** Either "the performance of the promise will satisfy an obligation of the promisee to ***pay money*** to the beneficiary;" or

   b. **Intended benefit:** "The circumstances indicate that the promisee ***intends to give the beneficiary the benefit*** of the promised performance." (§ 302(1)(a) and (b)).

      Note: These two kinds of "intended beneficiaries" sound a lot like the old "creditor" and "donee" beneficiaries. But Comment d to Rest. § 302 lists several situations in which a beneficiary will be "intended," although he would *not* have been either a "donee" or a "creditor" beneficiary. For instance, if the promisee ***believes he owes*** the third party a duty but he in fact does not, many older cases would have held that the third person was not a true "creditor beneficiary," and would not have allowed recovery, whereas the Second Restatement would allow such recovery.

3. **Incidental beneficiaries:** Even though the Second Restatement has broadened the class of third parties who may sue, it by no means gives such a right to all persons who would be benefited by the performance of a contract. The Restatement gives the following illustration of a contract in which the third person is merely an ***"incidental"*** beneficiary, rather than an "intended" one, and therefore ***may not sue.***

   Example: "*B* contracts with *A* to buy a new car manufactured by *C*. *C* is an incidental beneficiary, even though the promise can only be performed if money is

paid to *C*." Rest. 2d, § 302, Illustr. 17.

4. **Factors to determine who is "intended" beneficiary:** In determining who is an "intended beneficiary," the primary question is whether the ***promisee*** intended that the third party have the benefit of the contract. But where the promisee's intention is not clear from his language, several other factors may be considered.

   a. **Reliance:** If the beneficiary would be reasonable in ***relying*** on the contract as having been intended to confer a right on her, she is an "intended" beneficiary. That is, the purpose of the contract may be looked at from the beneficiary's point of view. See Comment d to Rest. 2d, § 302.

   b. **To whom performance runs:** If the performance is to ***run directly*** from the promisor ***to the third party***, the third party is usually an intended beneficiary. On the other hand, if the performance is to run from the promisor to the promisee, and the third party's benefit will only be indirect, he is probably just an incidental beneficiary. C&P, p. 645.

      Example: Bank promises to give Borrower a loan, so that he can pay his creditor *C*. Since Bank's performance is to be made directly to Borrower, and *C* would benefit only indirectly, he would probably not be an intended beneficiary. If, on the other hand, the contract between Bank and Borrower provided that Bank was to pay *C* directly, C would be an intended beneficiary, and could sue Bank for breach of the contract. See C&P, p. 645. (Bank would also fall within the "payment of money" category of Rest. 2d, § 302(1)(a)).

      Caveat: This "to whom performance runs" test will not always be dispositive, however — it's just one factor in the analysis. Thus in one well-known case, X, a testator, hired D, a lawyer, to write a will for him. The will was to make the Ps beneficiaries of a trust set up by D. However, it turned out that the trust was invalid, and the Ps ended up getting $75,000 less than they would have had the trust been valid. The court held that the Ps could theoretically recover from D on a third party beneficiary theory; their being benefited was the "main purpose" of the hiring of D to write the will, and it was irrelevant that in this case performance was not to be rendered to them. (However, the court found that there was no actual liability, since the rules on perpetuities and alienation, which caused the trust to be invalid, were so confusing that D's error was excusable.) *Lucas v. Hamm*, 364 P.2d 685 (Cal. 1961).

   c. **Carrying out of parties' intentions:** A beneficiary may be an "intended" one even though helping the beneficiary was not the ***"primary"*** intent of the parties, as long as giving him these benefits

was ***part of the parties' overall object***.

i. **Promisor's intent:** Most courts seem to agree that the promis*ee*'s intent is the one of primary interest. Some courts seem to say that this is the *only* intent that matters, i.e., that if the promisee intends to benefit the third party, that third party is an ***intended*** beneficiary even if the promisor has no such intention. But other courts — though probably a minority — hold that ***both*** the promisor and the promisee must have intended to benefit the third party.

5. **Beneficiary's assent or knowledge unnecessary:** The intended beneficiary has a right to sue despite the fact that at the time the contract was made, he didn't ***know about it***, or, if he did know about it, ***did not assent*** to it.

D. **Some frequently arising situations:** We examine now several frequently arising situations in which the right of a third party to sue is in question.

1. **Public contracts:** ***Governments***, whether federal, state or municipal, frequently make contracts with private companies under which the private company will perform services that will benefit the public. In all such cases, the contract is presumably for the benefit of the public. Yet as a general rule, ***a member of the public who is injured*** by the fact that the contractor does not perform may ***not*** sue.

Example: Water Company enters into a contract with the city of Rensselaer, in which it promises to supply water for fire hydrants. A building in the city belonging to P burns down, due in part to the fact that Water Co. did not maintain adequate pressure in the hydrants.

Held, P may not sue Water Co. The parties to the contract showed no intent to give each individual citizen the right to sue. (Furthermore, to allow each citizen to sue would make Water Co. an insurer against fire loss, with consequent prohibitive boosts in water rates.) *H.R. Moch Co., Inc. v. Rensselaer Water Co.*, 159 N.E. 896 (N.Y. 1928).

a. **Exceptions:** In several kinds of situations, however, members of the public will be allowed to recover against a contractor who breaches his contract with the government. The Second Restatement specifies two particular situations in which a member of the public ***will be allowed to sue:***

i. **Expressly provided:** A member of the public may sue if the party contracting with the government has ***explicitly promised to undertake liability*** to members of the public for breach. Rest. 2d, § 313(2)(a).

ii. **Government has own liability:** If the government has a ***duty of its own*** to provide the service which it has contracted for, a citizen may sue the party who contracted to perform those services. Rest. 2d, § 313(2)(b).

Example: "*A*, a municipality, owes a duty to the public to keep its streets in repair. *B*, a street railway company, contracts to keep a portion of these streets in repair but fails to do so. *C*, a member of the public, is injured thereby. He may bring an action against *A* and *B* and can recover judgment against each of them." Rest. 2d, § 313, Illustr. 5.

2. **Real estate neighbors:** A party who owns ***real estat***e the value of which would be enhanced by construction on a ***nearby parcel*** is an ***incidental*** beneficiary, with respect to the parties who contract to perform or facilitate the construction. So the real estate owner can't sue either of the original contracting parties if one of them breaches.

Example: Ohn owns a vacant parcel of land adjacent to a parcel owned by Neigh. Bank contracts to lend Ohn enough money to build an office building on Ohn's parcel. If the building were built, Neigh's parcel would immediately become much more valuable. However, since there's no sign that Ohn (or Bank) is motivated by a desire to confer a benefit on Neigh, Neigh is just an incidental beneficiary of the Ohn-Bank contract. Therefore, if Bank fails to fund the promised loan, Neigh can't recover against Bank. Cf. Rest. 2d, § 302, Illustr. 16.

3. **Mortgage assumptions:** The transfer of ***mortgaged real estate*** gives rise to third party beneficiary problems in several different contexts. Before examining these problems, it is necessary to understand exactly what a mortgage is. It consists of two parts: (1) a promise by the mortgagor to pay back a loan made to him by the mortgagee; this promise is evidenced by a promissory note or bond; and (2) a security interest, which gives the mortgagee the right to foreclose upon the property if the mortgagor does not pay back the debt.

a. **Two ways to transfer mortgaged property:** When the mortgagor wishes to sell the mortgaged property, he can do so in one of two principal ways:

□ First, he can sell the property ***"subject to"*** the mortgage. This

means that the purchaser does not undertake to pay off the mortgage (i.e., he does not make himself personally liable for the amount of the mortgage debt). However, if he does not see that the mortgage payments are made, the mortgagee will be able to repossess anyway (but will not be able to get a deficiency judgment against the purchaser for the difference between the foreclosure price and the unpaid debt).

- Alternatively, the purchaser may ***"assume"*** the mortgage. If he assumes the mortgage, he makes himself personally liable for its repayment; if he falls behind, the mortgagee may not only foreclose, but may also obtain a deficiency judgment against the purchaser.

Let's consider each scenario, with the assumption one first.

b. Mortgagee's rights where assumption has occurred: If the purchaser has ***assumed*** the mortgage, all courts agree that the ***mortgagee*** (i.e., the lender) is a ***creditor beneficiary*** of the assumption agreement between seller and buyer. The mortgagee may therefore ***sue the purchaser to compel him to make the mortgage payments.*** If this purchaser in turn sells to another purchaser (whom we shall call a "sub-purchaser"), who also assumes the mortgage, the mortgagee will be able to recover against the sub-purchaser as a third party beneficiary in the same way that he could against the original purchaser.

c. Mortagee has no right where property is taken "subject to": If the purchaser merely takes ***"subject to"*** the mortgage, there is no promise by the purchaser to *anyone* that the purchaser will pay the mortgage. Therefore, there is ***no promise*** on which the mortgagee could possibly be a third party beneficiary, and his only remedy is to repossess, not to recover a deficiency judgment.

d. Where first purchaser takes "subject to" the mortgage and second one assumes it: Now, suppose that in an initial transaction, the original mortgagor sells to a purchaser who takes subject to the mortgage rather than assuming it. As we've just seen, the mortgagee obviously cannot sue that purchaser, since he has never promised to pay. But then suppose that this non-assuming

purchaser ***sells to a sub-purchaser who does assume the mortgage.*** May the mortgagee sue this assuming sub-purchaser? Courts are ***split*** on this issue.

E. Discharge or modification by the original parties: Suppose that a contract has been created which creates enforceable rights in a third party. After these rights have been created, may the original parties then agree to ***discharge or modify the contract***, changing or eliminating the third parties' rights?

1. Second Restatement uses unified test: Modern courts generally follow the Second Restatement's rule. Under that rule, the original parties' power to modify the contract ***terminates*** when the beneficiary, before he receives notification of the discharge or modification, does any of the following:

□ materially ***changes his position in justifiable reliance*** on the promise; or

□ ***brings suit*** on the promise; or

□ ***manifests assent*** to it at the request of the promisor or promisee.

Rest. 2d, § 311(3).

a. Original parties maintain right to modify or discharge: This rule means that until one of the three events listed above occurs, the original parties ***maintain the power to modify or discharge*** the beneficiary's rights. But if any of the three events occurs before the beneficiary gets notice of a modification or discharge, the beneficiary's rights ***"vest,"*** and can no longer be altered by the original parties.

Example: Uncle and Landowner, the owner of Blackacre, sign an agreement under which Uncle promises to deposit $100,000 in Landowner's bank account by April 1, and in return Landowner promises that on April 2, he will convey Blackacre to Uncle's nephew Nick. (Assume that Nick is an intended beneficiary of this agreement.) Uncle sends a copy of the agreement to Nick, and says, "Let me know whether you agree to receive title to Blackacre as provided in this document." On March 26, Nick responds, "That's great, yes, I agree. Thanks, Unc." On March 30, Uncle and Landowner sign an amendment to the agreement, purporting to discharge Uncle's obligation to pay the $100,000 and Landowner's obligation to transfer title to Nick.

When Nick "manifested assent" to the agreement at the request of one of the original parties, this assent took away Uncle's and Landowner's power to modify

the agreement as it concerned Nick. Therefore, Nick can sue both Uncle and Landowner for breach on account of their purported modification. The same would be true if Nick, instead of manifesting assent, had changed his position in reliance (e.g., by giving up the chance to buy some alternative property because he knew he could count on receiving Blackacre).

b. Clause preventing subsequent modification: The original parties may, however, themselves ***agree*** at the time of contracting that no subsequent modification may occur without the beneficiary's consent. Such a clause will be ***honored***. Rest. 2d, § 311(1).

2. Life insurance policies: Most ***life insurance*** policies contain a clause reserving to the owner of the policy the right to change the beneficiary at will. Such a clause will almost always be ***enforced***, and if the original beneficiary is dropped from the policy, he will not be able to sue the insurer. Conversely, if the policy states that power to change the beneficiary is not reserved, that clause will also be honored, and the original beneficiary can sue for the proceeds despite a purported change.

F. Defenses against the beneficiary: If a third party beneficiary leaps over all the hurdles which we have discussed thus far, he will be able to sue the promisor to compel him to perform. But as a general rule, the promisor-defendant will be able to assert against the beneficiary ***any defenses which he could have asserted had he been sued by the promisee***. The beneficiary is said to ***"step into the shoes of the promisee."*** Thus the defendant may show that there was no mutual assent between the promisee and himself, that there was a mutual mistake, that the promisee gave no consideration, etc.

1. Defense that promisee breached: Most important, this principle means that if the promisee never rendered the performance which he promised under the contract (i.e., the promisee ***breached***), the promisor may ***assert this lack of performance*** in defense to the beneficiary's suit. See Rest. 2d, § 309(2).

Example: Seller contracts to deliver goods to Buyer, who promises that upon delivery, he will pay $1,000 to Supplier, Seller's creditor. Seller delivers defective goods and fails to cure the non-conformity. Buyer refuses to pay the $1,000, and is sued by Supplier. Buyer may assert as a defense the fact that Seller breached the contract.

2. Exception for defense of modification or rescission: An exception

to the general rule that the promisor may use against the beneficiary any defense which she could have used against the promisee, is that the promisor may not always assert the defense that the promisee has ***discharged*** her from the contract, or otherwise modified it. As was developed above, the beneficiary's right in some circumstances becomes "vested," and any subsequent modification or release granted by the promisee will not be valid as against the beneficiary. *Supra*, p. 420.

G. Beneficiary versus promisee: When the promisor promises to pay the promisee's debt to a creditor beneficiary, the latter may, as we have seen, sue the promisor directly. If the creditor does so, does she forfeit her right to sue the promisee?

1. Creditor may sue: Most courts, and the Second Restatement (§ 310(1)), hold that the answer is "no" — the creditor beneficiary, by bringing suit against the promisor, does not release the promisee, so the creditor ***may later sue the promisee***. (She is, however, entitled to only one satisfaction.)

> **Example:** Contractor agrees to paint Owner's house for $10,000, with payment to be made to Friend, in repayment of a $10,000 debt owed by Contractor to Friend. Owner does not make payment, and Friend sues Owner as a third party beneficiary. Owner defends with partial success on the grounds that Contractor did not perform the painting work to the contract specifications. Therefore, Friend recovers only $6,000 from Owner (because the court gives Owner a set-off for $4,000 in damages for breach). Now, Friend may sue Contractor for the remaining $4,000 due on the original Contractor-Friend debt — Friend will not be deemed to have given up the right to sue Contractor by virtue of having sued Owner.

a. Suit by promisee: If the promisee ends up paying all or part of the claim to the creditor beneficiary, the promisee may recover ***reimbursement*** from the promisor. Rest. 2d, § 310(2).

2. Promisee's right against the promisor: Most courts allow the promisee to bring his own suit against the promisor for the benefit of the third party beneficiary, if the promisor breaches.

a. Third party is creditor beneficiary: This is most important where the third party is a ***creditor*** beneficiary. Here, most courts let the promisee-debtor recover from the promisor the amount which the promisor promised that he would pay the creditor (at least where the promisee has already paid the debt to the creditor).

Example: Same facts as above Example. Now, however, assume that Contractor does the work correctly, but Owner doesn't pay any of the $10,000 due. At least if Contractor (the promisee/debtor) pays his debt to Friend first, Contractor gets to sue Owner (the promisor) to recover the $10,000. (Some courts would let Contractor bring the suit even if he hadn't yet paid off Friend.)

H. The UCC and third party beneficiaries: The UCC has no general provisions dealing with third party beneficiaries. It does, however, provide that in a sales contract, certain persons who are not parties to the contract may sue for breach of ***warranties*** that the seller has made. Two separate questions are involved: (1) May the buyer sue not only his immediate seller, but the person who sold the goods to the seller, or who manufactured them?; and (2) May anyone other than the buyer (e.g., a member of the buyer's household, a bystander, etc.), if he is harmed by a breach of warranty, sue either the buyer's immediate seller or the remote seller or manufacturer? These questions are discussed in the chapter on Warranties, *infra*, p. 497.

1. Common law fills gap: Other third party beneficiary problems that may arise in a sale-of-goods case are not disposed of by the Code. For instance, a buyer might contract for goods to be delivered to some third party to satisfy a business obligation; if the goods are never delivered (as opposed to being delivered in a defective state, breaching warranties), the Code provides no clue as to whether the beneficiary may sue. But remember that the Code, like any statute, is ***supplemented by the common law*** where the Code is silent. UCC § 1-103(b).

Quiz Yourself on
THIRD PARTY BENEFICIARIES

114. O'Hara owns Tara, a plantation. She hires Selznick to build a movie set in the backyard, which will enhance the value of the property next door, Twelve Oaks, owned by Wilkes. When Wilkes learns of the pending set project, Wilkes adds a souvenir hut to his front yard. Selznick breaches the contract with O'Hara and the set is never built. May Wilkes sue Selznick as a third party beneficiary to the O'Hara-Wilkes contract?

115. Gretel eats $500 worth of gingerbread from the walls of Witch's home, and Witch demands $500 from her. Shortly thereafter, Hansel, Gretel's

brother, enters into a contract with Mother Goose Publishing to write his autobiography. In the publishing contract, at Hansel's request, Mother Goose agrees to pay part of the royalties to Witch to pay for the damage caused by Gretel. (Hansel doesn't like to see his sister burdened down by debt.) If Mother Goose doesn't pay the royalties to Witch, can Gretel sue Mother Goose?

116. Dorothy contracts to appear in Wizard's play. The agreement provides that Wizard will also tender a standard Actors Equity acting contract to Dorothy's friends Scarecrow, Lion and Tin Man, for co-leading roles in the production. Dorothy shows her friends her contract with Wizard. They express to her their delight that they'll be getting roles, and they all buy new wardrobes to be worn in the show. Subsequently, Wizard decides not to produce the play, and he and Dorothy agree to rescind the agreement.

(A) Assume that the contract says nothing about whether or when the parties may modify or rescind the agreement. May Dorothy's friends recover against Wizard for failing to tender them contracts?

(B) Assume, for this part only, that the Dorothy-Wizard contract contained the following provision: "The parties may at any time, by mutual agreement, modify or rescind this agreement without consideration." If all other facts are the same, may Dorothy's friends recover against Wizard for failing to tender them contracts?

117. Betsy Ross contracts to deliver 50 hand-sewn Stars and Stripes flags to Washington. Washington promises Betsy in return that once he receives the flags, he will pay off Betsy's $500 debt to Singer. Betsy tells Singer about the agreement. Betsy delivers the flags, but unfortunately the flags are red, white, and chartreuse instead of the contracted-for red, white and blue. Betsy refuses to correct the defect, and Washington refuses to pay Singer. Singer sues Washington for the $500. Does Washington have a valid defense?

Answers

114. No. A beneficiary may sue the promisor only if the beneficiary was an "intended" beneficiary. A beneficiary is "intended" if the circumstances

indicate that the promisee intended to give the beneficiary the benefit of the promised performance. Here, there is no evidence that O'Hara (the promisee) intended to give Wilkes the benefit of the promised set — Wilkes was essentially a bystander whose very existence was probably not even considered by O'Hara when O'Hara made the set deal. Therefore, Wilkes was an "incidental" (not "intended") beneficiary, and as such, has no right to sue on the promise.

115. Yes. A non-party who would benefit by performance of a contractual promise may sue if the non-party is found to be an "intended" beneficiary. Where the promisee's purpose in bargaining for the promise is, at least in part, to confer a benefit on the beneficiary, the beneficiary is "intended." Here, although Hansel doesn't personally owe money to Witch, he clearly has a desire to see his sister's debt repaid. Therefore, he's intentionally attempting to confer a benefit on her by extracting the promise from Mother Goose that she'll part off the debt. Consequently, Hansel is an intended beneficiary, and may sue.

Note that these facts present an exception to the general rule-of-thumb that when performance does not run directly to the beneficiary, the beneficiary is probably not "intended" — here, the payment will go to Witch, not Gretel, but Gretel is still an intended beneficiary since Hansel intends that Gretel benefit by having her debt be extinguished.

116. (A) Yes, probably. The rule is that a beneficiary's rights "vest," making his rights irrevocable, when one of three events occurs: (1) the beneficiary materially changes his position in justifiable reliance on the promise; (2) he brings suit on it; or (3) he manifests his assent to the contract at the request of one of the parties. Here, the third party beneficiaries have materially relied on the contract to their detriment, by buying expensive wardrobes. Assuming that their reliance was reasonable, they will be able to recover in their suit. (An alternative rationale is that when the friends were shown the agreement by Dorothy and expressed their delight, this constituted their "assent" to the contract at Dorothy's request, making their rights irrevocable.)

(B) No, probably. Although a beneficiary's rights normally vest upon any of the three types of events described in the answer to Part (A), the original parties are always free to retain the right to vary this rule. Here,

Dorothy and Wizard's retention of the right to modify or rescind the contract (even though they don't mention the effect this will have on the three friends) will probably be interpreted as an implicit variation of these normal vesting rules. If so, the fact that the friends materially relied on (or manifested their assent to) the promise will be irrelevant.

117. Yes. When an intended beneficiary (Singer) sues the promisor (Washington) under a contract, the promisor has the same defenses as he would have against the promisee (Betsy Ross). Thus, breach of contract (as here), lack of mutuality or consideration, fraud, duress, or mutual mistake will all be valid defenses against the beneficiary.

EXAM TIPS ON CONTRACTS INVOLVING MORE THAN TWO PARTIES

Material from this chapter is heavily tested. Look for a fact pattern where rights or duties are created in a third person either when or after the contract has been executed.

Assignment and Delegation

- ☛ Remember that an ***assignment*** is a transfer of contract ***rights,*** and a ***delegation*** is a transfer of contract ***duties***.
- ☛ Be sure to check whether the contract may be assigned, and/or delegated:

  When assignment is allowed:

  - ☞ **Consideration:** Don't worry if the assignment isn't supported by ***consideration***. Consideration is unnecessary where there's a present transfer of rights.
  - ☞ **Generally permissible:** Where the contract is ***silent*** on whether assignment is allowed, the contract is ***assignable,*** even without the obligor's consent.

- ☞ **Anti-assignment clause:** If a contract contains an anti-assignment clause, an act of assignment gives the obligor a right to ***damages*** against the assignor for breach, but ***does not render the assignment ineffective*** (unless the assignment imposes an material additional burden on the obligor, or would be void for some other reason independent of the anti-assignment clause).

When delegation is allowed:

- ☞ **Nondelegable duties:** In delegation cases, check that the duties are in fact delegable. Remember that the main rule is that delegation is permitted unless the obligee (the one to whom the delegated performance is due) has a ***"substantial interest in having the delegator perform."***

  - ☞ Personal services: Contracts for performance of ***personal services*** are generally ***not delegable*** by the person who would do the work.

    Example 1: Contracts of ***employment***, which are not be delegable by the employ*ee.*

    Example 2: Contracts with ***independent contractors possessing special personal skills***, such as musical performers, architects, computer programmers, etc.

    Note: In these personal-service circumstances, the delegation may be deemed an ***anticipatory repudiation,*** in which case the obligee can immediately cancel the contract and sue the delegator for breach.

  - ☞ **Construction contracts:** Generally, an obligation under a ***construction contract*** is ***not*** considered a personal service and may be assigned.

  - ☞ *Important distinction:* A ***delegation*** of the duty to perform personal services is more likely prohibited than an ***assignment*** of the right to receive the services (which is prohibited only if it materially alters the duty of the obligor).

    Example 1: The rights to receive the benefits of a one-year contract for gardening services performed for an owner of a condominium may probably be transferred to the party to whom he sells the condominium. (The duty to make payment may also be assigned, though the assignor remains liable as

guarantor.)

Example 2: The rights to a musical performance at one party's wedding may be transferred to another party having a wedding, if all the contract terms (place, time, date, contract price) are the same.

- ☞ **Waiver:** Remember that even if the contract is nondelegable, the right to object may be ***waived***.

Example: Ohn, the owner of a piece of undeveloped land, enters into a contract with Arch, an architect, whereby Arch agrees to produce and deliver by May 1 a design of a ten-story hotel to be built on the land. On January 15, because of health problems, Arch is ordered to take a six-month break from work by his physician. Arch signs a documents "assigning" to Bench — a well-known architect with whom Arch has sometimes collaborated — all Arch's rights and duties under the contract with Ohn. One week later, Bench meets with Ohn to discuss preliminary plans with him. Thereafter, he communicates with Ohn by phone. When Bench submits the completed design on May 1, Ohn refuses to accept it.

Ohn, by failing to object to the assignment during his initial encounters with Bench, has probably waived his right to object.

- ☞ **Demand for assurances:** When the party who is owed the performance receives notice of a delegation of duties, she may demand ***assurances of performance*** from the delegate, and may suspend her own performance until assurances are furnished.

☛ **Rights and obligations on assignor/delegator side:** Remember to evaluate the ***rights*** and ***obligations*** of the ***assignor or delegator.***

Assignor's right to revoke:

- ☞ **Assignor relinquishes rights:** In an assignment, an assignor's rights are ***extinguished*** once there has been an effective assignment. Therefore, don't make the mistake of allowing the assignor to sue to enforce rights previously held by her.
- ☞ **Assignments for consideration are irrevocable:** Also, watch for an assignment that is supported by ***consideration*** — such an assignment is ***irrevocable***, so the assignor can't change her mind and cancel the assignment.
  - ☞ **Gratuitous assignment:** By contrast, a ***gratuitous*** assignment is ***revocable*** by the assignor, unless one of the following happens:
    - □ the assignor ***delivers a symbolic document*** evidencing the

rights (e.g., hands over a bankbook, which would make assignment of the bank account irrevocable);

- ☐ the assignor puts the assignment in ***writing***;
- ☐ the assignee ***foreseeably relies*** to his detriment on the assignment or
- ☐ the obligor ***gives performance*** to the assignee.

Delegator's ongoing liability:

- ☞ A delegation of contract duties doesn't divest the ***delegator*** of her obligations to the obligor. Thus, ***the delegator can be sued if the delegate breaches.***

  Example: Store, a retailer of home gardening supplies, enters into a one-year contract with Seedco, a wholesaler of seeds, whereby Seedco will supply Store with all of its requirements for rye grass seeds on a monthly basis. After delivering one delivery of rye grass seeds to Store, Seedco sells its business to Byer, who fulfills Store's next month's requirement of seeds. Store pays Byer for the seeds, but also demands that Byer assure it that it will be able to meet Store's future rye grass seed needs. Five weeks later Store has still not heard from Byer and notifies Seedco and Byer that it's canceling the contract.

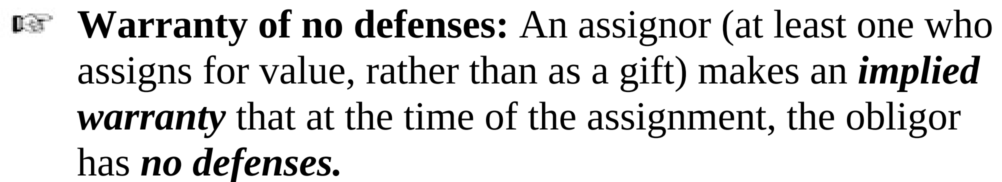
  Store may successfully sue *Seedco* for breach of contract — the delegation by Seedco to Byer did not relieve Seedco of liability if Byer should not perform.

  - ☞ *Trap:* A fact pattern may indicate that an obligee has ***consented*** to the delegation. This consent does ***not*** relieve the delegator of liability, unless the obligee ***explicitly agrees*** to release the delegator (in which case there is said to be a "novation.")

☛ **Rights and obligations of assignee:** Also, analyze the ***rights*** of the ***assignee***.

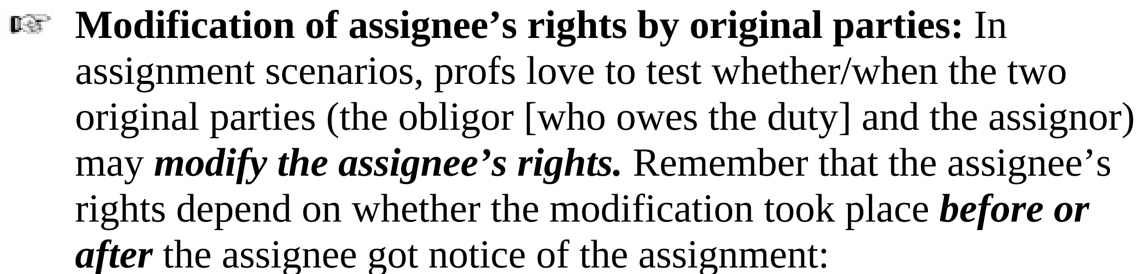
- ☞ **Assignee steps into assignor's shoes:** The assignee is entitled to ***enforce the contract rights*** to the same extent that the assignor could have — the assignee ***"steps in to the assignor's shoes."***
  - ☞ **Subject to defenses:** However, the assignee's right to enforce the contract is ***subject to any defenses*** which could have been asserted against the assignor, such as ***breach*** of the assignor's return promise, ***lack of consideration***, or occurrence of a ***condition*** to the defendant's duty.

Example: Pawn, a pawnbroker, sells to Jewel, owner of a jewelry store, a ring for $2,500, representing it to contain a diamond. The following month, Pawn sells Jewel a pearl necklace for $2,200, to be paid for within thirty days. Before Jewel pays for the necklace, he learns that the ring he previously purchased contains a cubic zirconia and is worth only $300. A day later, Pawn assigns his rights to payment for the necklace to Art. Since Art steps into Pawn's shoes, if Art sues Jewel for payment on the necklace, Jewel can successfully assert against Art (at least as a set-off to reduce Art's recovery) the breach-of-contract claim regarding the ring.

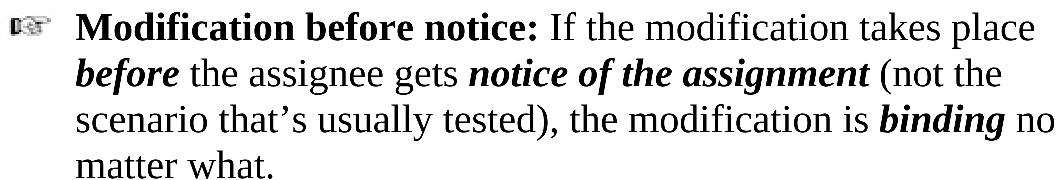


- **Warranty of no defenses:** An assignor (at least one who assigns for value, rather than as a gift) makes an ***implied warranty*** that at the time of the assignment, the obligor has ***no defenses.***

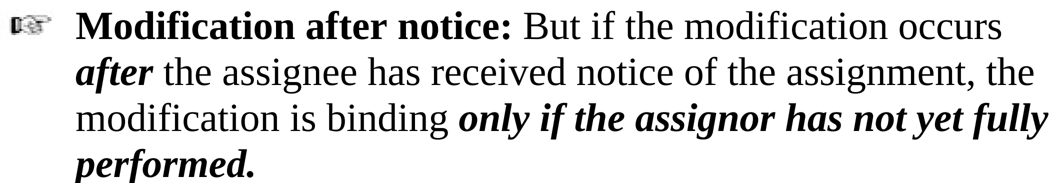
Example: Thus in the above example, if Pawn assigns to Art for value his right to payment from Jewel, Pawn has impliedly warranted to Art that Jewel has no defenses. Since Jewel has a defense against Pawn, Pawn has breached the implied warranty and is liable to Art for any amount by which Art's claim against Jewel is reduced.



- **Modification of assignee's rights by original parties:** In assignment scenarios, profs love to test whether/when the two original parties (the obligor [who owes the duty] and the assignor) may ***modify the assignee's rights.*** Remember that the assignee's rights depend on whether the modification took place ***before or after*** the assignee got notice of the assignment:



- **Modification before notice:** If the modification takes place ***before*** the assignee gets ***notice of the assignment*** (not the scenario that's usually tested), the modification is ***binding*** no matter what.



- **Modification after notice:** But if the modification occurs ***after*** the assignee has received notice of the assignment, the modification is binding ***only if the assignor has not yet fully performed.***

Example: Conti, a contractor, agrees to build a house for Owen, at a price of $300,000. Since Conti owes $400,000 to Bert, Conti's brother, Conti assigns to Bert Conti's right to receive payment from Owen, and immediately notifies Bert of the assignment. Then, Owen and Conti agree to a price reduction to $250,000. If the price reduction occurred before Conti finished the work, Bert is bound. But if the reduction occurred after Conti finished, the reduction is not binding on Bert, and Bert can sue for the whole $300,000.

- ☞ **Multiple assignments:** Also, look for a fact pattern where there have been ***two assignments*** of the same right. If the first assignment is irrevocable, then, generally, that first assignee has priority.

- ☞ **Prior payment as defense:** Remember that timing also counts where the obligor pays (or gives performance to) the assignor instead of the assignee. If the obligor pays the assignor (in part or in full) or gives the required performance ***before he has received notice of the assignment***, he may ***use this as a defense*** against the assignee. But if the obligor renders payment/performance to the assignor ***after*** learning of the assignment, she may ***not*** use this as a defense vis a vis the assignee.

  Example: In the above example, suppose Owen paid $200,000 to Conti (rather than to Bert) after Owen got notice of the assignment. Owen would not be able to use this payment as a set-off in an action for the $300,000 brought against him by Bert.

Third Party Beneficiaries

- ☛ This topic is always a favorite on exams. The two most important issues to concentrate on are the distinction between intended and incidental beneficiaries, and the analysis of whether an intended beneficiary's rights have vested.

  - ☞ **Intended vs. incidental:** You must distinguish between these two types of beneficiaries, because the ***intended*** beneficiary may ***enforce*** the contract whereas the ***incidental beneficiary cannot.***

    - ☞ **Creditor:** If the agreement is to ***pay money*** that one of the original parties owes to a third party, that third party is an intended beneficiary, and may sue. (This is the classic "creditor beneficiary" situation).

      Example: Own hires Gard to landscape Own's property for $90,000. The contract provides that Own is to pay $80,000 to Gard and the balance is to paid to Cred, to whom Gard owes money. Cred is an intended beneficiary of the contract between Own and Gard. Therefore, Cred may sue if Own doesn't pay.

    - ☞ **To whom performance runs:** Look at whether the performance ***runs directly*** from the promisor to the third

party. If it does, the beneficiary is probably "intended." If not, the beneficiary is probably incidental.

Example: Whole, a wholesaler, agrees to supply to Ret, a retailer, 100 bicycles made by Manco. Ret is to pay Whole, who will then order from, and pay, Manco. Because Ret's performance (payment) is to run to Whole, not to Manco, Manco is not an intended beneficiary, and may not sue Ret if Ret cancels the contract.

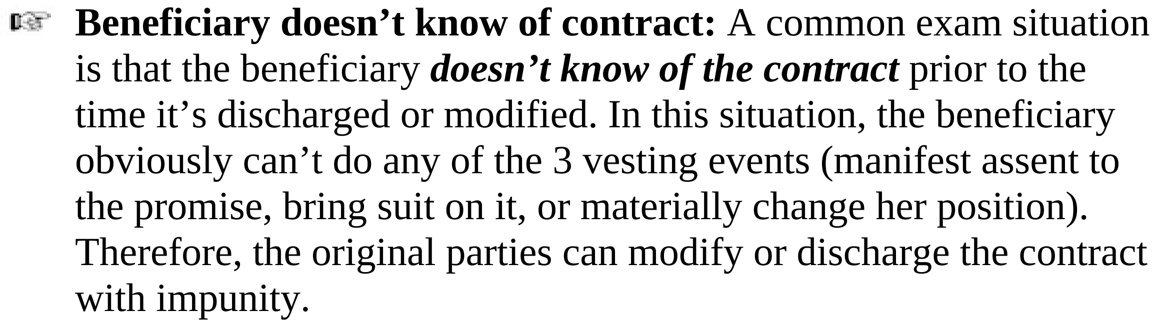
- ☞ **Promisee's intent:** Pay the closest attention to the intent of the ***promisee***, not the promisor — if the promisee didn't intend to benefit the third party, the latter is not an intended beneficiary.
  - ☞ *Trap:* The mere fact that a third party is ***mentioned*** in a contract doesn't automatically mean that he's an intended beneficiary. Analyze whether the promisee really intended to benefit the third party.

    Example: Cli owes Lawr money for legal services. Lawr suggests to Cli, "I'd like you to pay me off by buying my nephew Neff a Goldray Special from the Zebra Car Agency — they've got good prices there." Cli responds, "If that's what you want, I'll be glad to do it." Neff is an intended beneficiary, because it's clear that Lawr (the promisee, to whom Cli owes money) intends to benefit Neff. (The fact that Cli has no particular desire to benefit Neff is irrelevant). On the other hand, there's no indication that Lawr intended to benefit Zebra — Lawr seems to have suggested Zebra by name merely because she wanted a good price, not because she had an affirmative desire to benefit Zebra. Therefore, Zebra is merely an incidental beneficiary.

- ☞ **Vesting as a bar to modification or discharge:** In exam fact patterns the two original parties often try to ***modify or discharge*** the obligation after it comes into existence. The general rule is that they may do this, but only until the beneficiary's rights have ***"vested."*** Vesting occurs when the beneficiary does one of these 3 things:
  - □ she ***manifests assent*** to the promise,
  - □ she ***brings suit*** on the promise, or
  - □ she ***materially changes her position in justifiable reliance*** on the promise.

  Examples of justifiable reliance: (1) A freelance book illustrator who is the beneficiary of full-time employment for a year notifies her other clients that she

can’t work for them. (2) A person who is the beneficiary of a promise to convey land cancels a contract for the purchase of a different parcel.



☞ **Beneficiary doesn’t know of contract:** A common exam situation is that the beneficiary ***doesn’t know of the contract*** prior to the time it’s discharged or modified. In this situation, the beneficiary obviously can’t do any of the 3 vesting events (manifest assent to the promise, bring suit on it, or materially change her position). Therefore, the original parties can modify or discharge the contract with impunity.

Example: Frank, owner of a house, hires Paynt, a painting contractor, to paint Frank’s residence. The contract price is $5,000, provided that Paynt delivers a “satisfactory result.” A provision in the contract directs that payment be made to Paynt’s daughter, Dot (intended as a wedding gift). When the job is completed, Frank says he doesn’t find it “satisfactory.” Paynt agrees to settle for a lower price of $4,500, provided the money’s paid directly to him. Paynt doesn’t give any of the money to Dot. Shortly thereafter, Dot finds out about the promise, and sues both Paynt and Frank for breach of the agreement. Dot will lose, because prior to the settlement (a modification), Dot didn’t manifest assent to receiving the money, didn’t bring suit on the agreement, and didn’t materially change her position in reliance. Therefore, Dot’s rights never vested.

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[1]. We say “normally,” because there are some kinds of assignments that are covered by Article 9 but do not have to be filed. In particular, an assignment of an “account” (the right to payment under a contract) does not have to be filed if it “does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor’s outstanding accounts[.]” § 9-309(2). Where both the first and second assignments fall within this exception to the filing requirement, the first assignee wins.