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WHEN SHOULD CONTRACTS  
BE ASSIGNABLE?  
AN ECONOMIC ANALYSIS

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## WHEN SHOULD CONTRACTS BE ASSIGNABLE? AN ECONOMIC ANALYSIS

*Jared G. Kramer*<sup>\*</sup>

### ABSTRACT

This Article explores the economic logic of contracting parties' choice between making contract rights and obligations assignable and making them non-assignable.

The analysis derives from the principle that parties will choose assignability, non-assignability, or something in between when that choice maximizes the joint value of the contract to the parties and therefore is mutually beneficial. The Article proceeds by discussing the reasons why in certain contexts restricting assignment may be more valuable to the parties than allowing it. Three of the reasons involve contexts where assignment can harm the non-assigning party by decreasing the value of a performance received or increasing the cost of an obligation owed. First, this may occur when one party's desired conduct is costly or impossible to specify by contract. Second, it may occur when the effectiveness of remedies against a promisor varies among potential promisors. Third, it may occur when one party bears another's non-conduct-related risk. Two other reasons are not concerned with the cost or value of performance — parties may restrict assignment to facilitate price discrimination, or to avoid assignment's administrative costs.

The Article also discusses considerations that can make assignability particularly valuable — such as the ability to overcome holdout problems that could frustrate transactions; or long-term contracts where one party's valuation of the contract may change drastically over time.

In discussing each consideration favoring or disfavoring assignability, this Article presents numerous examples of actual contracts, discussing whether these contracts restrict assignment, and why the parties would write them as they did. The result is a more comprehensive and nuanced explanation of actual practices in contract assignment than exists in the current literature.

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<sup>\*</sup> Law Clerk to Chief Judge Michael Boudin, U.S. Court of Appeals for the First Circuit. Many thanks to Steven Shavell, Louis Kaplow, Robert Jackson and participants of the Law & Economics Seminar at Harvard Law School for their comments. I am grateful to the John M. Olin Center for Law, Economics and Business at Harvard Law School for research support.

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# WHEN SHOULD CONTRACTS BE ASSIGNABLE? AN ECONOMIC ANALYSIS

*Jared G. Kramer*\*

## **Introduction**

It makes economic sense to presume that it is optimal for contract rights and obligations to be assignable. Just as we like transferable property rights, transferability lets those with contract rights to sell them to those who value the rights more; and it lets those bound by contract obligations to have those obligations performed by someone who can do it at lower cost. For example, rights to payment in accounts receivable are often assignable: businesses can sell them to debt-collection firms, who because of their specialization extract more value per unit cost of servicing the accounts. And cell phone customer agreements are assignable by the service providers: Verizon investors may find it a better use of capital to sell their customers to Sprint if Sprint can provide the service at a lower cost.

This Article explores the economic logic of contracting parties' choice between making contract rights and obligations assignable and making them non-assignable. The basic point is that a contract term is mutually beneficial and will be included in the contract if and only if it maximizes the joint value of the contract to the parties. Permitting assignment may do that — the right to assign may increase the value to the assigning party (an apartment tenant who expects to transfer jobs and may want the ability to transfer his lease) more than it harms the other party (the landlord who isn't too picky about who lives in her building). But sometimes restricting assignment maximizes joint value — the right to assign may harm the non-assigning party (the landlord who is very picky) more than it benefits the potential assigning party (the tenant who is content to wait until the end of the lease to move out).

In other terms, if permitting assignment enables one party to locate someone who can get more value out of that party's end of the contract without causing too much harm to the second party, then a contract that permits assignment creates more value to be shared between the parties

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\* Law Clerk to Chief Judge Michael Boudin, U.S. Court of Appeals for the First Circuit. J.D., Harvard Law School, 2004. Many thanks to Steven Shavell, Louis Kaplow, Robert Jackson and participants of the Law & Economics Seminar at Harvard Law School for their comments. I am grateful to the John M. Olin Center for Law, Economics and Business at Harvard Law School for research support.

than a contract that does not. But if the transferee gets only slightly more value than the initial party, and the non-assigning party is significantly harmed by the transfer, then a contract prohibiting assignment is more valuable.

Presuming that assignability is usually optimal, this Article identifies five considerations that are likely to lead parties to limit assignment. The first three depend on the fact that different promisors may provide performances of different value to a promisee; and different promisees may cause a promisor to incur different costs to perform. These three categories are situations in which assignment from high-value promisors/low-cost promisees to low-value/high-cost promisees is a danger.

The first is when some part of the desired performance from one party is unspecifiable. The contract has wiggle room, so less adequate assignees may deliver a less-than-desired performance without breaching the contract, but there had been an expectation that the original party would do it right. This can arise when it is impossible or too costly to specify the details of what is desired. Relatedly, elements of performance may be unspecified because it is more valuable to preserve a performing party's flexibility in the future, for example to respond to changing business conditions.<sup>1</sup> An example of this situation is a contract for a musical performance: a concert hall owner hires Yo Yo Ma to play a sonata. The contract cannot and will not specify exactly how the sonata is to be played. If the contract could be assigned, the lack of specificity would mean that a substitute performer of less skill play the sonata without breaching the contract. This will inflict great harm from the loss of a world-class performer on the concert hall owner; the harm will probably exceed Yo Yo Ma's gain from transferring the contract, and the contract will thus be made non-assignable.<sup>2</sup>

The second factor is the varying adequacy of remedies and ability to enforce even well-specified obligations of promisors. Rather than the problem being that parties cannot specify

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<sup>1</sup> This can be viewed as merely an example of too-costly contracting — parties could in theory write down how optimally to respond to every conceivable contingency in the future, but the cost of doing this would be immense.

<sup>2</sup> Yo Yo Ma would receive a premium payment from the assignee, who might not win such a contract on his own merits. But the possibility that Yo Yo Ma would transfer the contract would mean less compensation from the concert hall, and a correspondingly lower premium upon transfer. The result is that Yo Yo Ma will not be able to fully profit from the value of his skill as a player. So unless he wants to be a booking agent, the value to him of transferability is not as great as the loss to the concert hall inflicted by the possibility of having Yo Yo Ma slip away.

desired performance, it is that it may be more costly to make some promisors (like judgment-proof ones) perform than it is to induce others to perform. Financing contracts fall most easily in this category. If I sell my house, I can't just transfer my mortgage obligations to the buyer: my bank will require me to pay off the loan. Although the obligation to pay \$2500 per month is clearly specified, the bank will worry that any purchaser will be less likely to pay because he may have less income or fewer assets.

Third, parties are likely to limit assignment by one party when the other party bears risk that is associated with the first party — and where the risk varies among potential assignees — that does not depend upon any conduct by that party.<sup>3</sup> An example here is flood insurance, where the risk borne by the insurer depends on geography: an assignment of an insurance policy from someone in an area without a river to someone in an area with a river will increase the risk borne by the insurer. Although this increase in cost to the insurer has nothing to do with the conduct of the assignor and assignee, the insurer will seek to prevent that assignment.

The other factors have little to do with the value of the assigning party's performance to the non-assigning party or a change in costs from performing for the assigning promisee to performing for an assignee. Fourth, parties may limit assignment to facilitate price discrimination. Here, one party desires to charge different prices to different customers based on their willingness to pay. Permitting assignment by the customer would permit arbitrage — the reselling of the contract by a low-price purchaser to a would-be high-price purchaser — that would undermine the price discrimination. Examples here include many kinds of tickets, such as airline tickets and ski lift tickets, where different people pay different prices — these tickets are often non-transferable.

Fifth, the direct costs of assignment may lead parties to limit assignment. Administrative costs of assignment such as keeping track of the counterparty and creating an infrastructure (such

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<sup>3</sup> To the extent that the level of risk borne by the second party depends on the first party's conduct, and to the extent that conduct is not specified by the contract, the contract merits the "unspecifiable performance" label. The boundary between the third and first factors is fuzzy. A health insurer would not want a customer to transfer her rights under her insurance policy to another person because it would likely be a transfer from a lower-risk person to a higher-risk person (else, why transfer?). This risk includes components that have nothing to do with the insured's conduct — such as her genetic makeup and age — and things that are conduct-related — such as whether she smokes.

as databases and call centers) to deal with transfers may impose costs on the non-assigning party not compensated by gains to the assignor.

In contrast, there are several factors that should increase the value of permitting assignment, or of permitting at least some assignments. One kind of contract that may favor assignments is long-term contracts: a party who might otherwise be prevented from assigning may value the ability to extract herself from a long-term commitment if her situation is likely to change over the course of the contract term. A situation in which partial assignability may be mutually beneficial is permitting transfer of contracts when that transfer occurs as part of the sale of an entire business. Permitting such assignments is very valuable to the assigning party — it permits that party to capture the going-concern value of the business, avoiding hold-out problems that could prevent the business from being sold to someone who values it highly.

The literature on contract assignment is relatively scarce. Much of it is scattered as small parts of more detailed treatments of particular kinds of contracts.<sup>4</sup> While many cases address the default rules of contract assignability when contracts are silent, these cases often turn on relatively conclusory applications of vague labels such as “personal services.”<sup>5</sup> Some commentators have addressed this body of default-rule case law, focusing especially on the category of personal service contracts.<sup>6</sup> But these treatments have neither encompassed all relevant considerations for restricting assignability,<sup>7</sup> nor given a thorough economic analysis of

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<sup>4</sup> See, e.g., George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1335–38 (1981); R. WILSON FREYERMUTH ET AL., ANATOMY OF A MORTGAGE 113–20 (2001); ROBERT E. KEETON & ALAN I. WIDISS, INSURANCE LAW § 4.1(c), at 297–304 (student ed. 1988).

<sup>5</sup> See *infra* section I.A.

<sup>6</sup> See Larry A. Dimatteo, *Depersonalization of Personal Service Contracts: The Search for a Modern Approach to Assignability*, 27 AKRON L. REV. 407 (1994); see also E. ALLAN FARNSWORTH, CONTRACTS §§ 11.4, 11.10 (3d ed. 1999).

<sup>7</sup> Dimatteo, *supra* note 6, criticizing the unwieldy and unpredictable personal-service contract jurisprudence, proposes several alternative approaches: looking to whether an assignment adversely affects or materially changes the duty of a contracting party, *see id.* at 431–433, 435–36, whether the services to be provided are “fungible,” *id.* at 436–437, and the extent to which contract obligations are specified or left to a party’s discretion, *id.* at 437–38. Contract non-assignability is discussed as a necessary tool for price discrimination in Larry E. Ribstein & Bruce H. Kobayahsi, *State Regulation of Electronic Commerce*, 51 EMORY L.J. 1, 17 (2002), but no comparison is made to other reasons for restricting contract assignment.

those that they do address, instead dedicating much effort to analyzing the reasoning of courts.<sup>8</sup> This Article seeks to fill these gaps by providing an economic analysis of why contracts are or are not made assignable, derived from the basic premise that a contract will be assignable or not when assignability or non-assignability is mutually beneficial — when assignability or non-assignability maximizes the joint value of the contract to the parties. Its approach is comprehensive, identifying a variety of considerations that will lead parties to deviate from the presumed default of assignability. Moreover, the Article uniquely contributes in exploring these considerations not by analyzing what courts say, but by providing evidence in the form of what parties actually do in writing a variety of contracts.<sup>9</sup>

The Article proceeds as follows: Part I describes the current contract law of assignability, comprising mostly default rules when contract rights and obligations should be deemed assignable when contracts are silent.<sup>10</sup> Part II provides the basic analytical model that describes the parties' decision whether to make a contract assignable. It describes the economic symmetry between assignment of rights and assignment (“delegation”) of obligations. It presents in analytical terms the functioning of partial restrictions on assignment such as provisions stating that consent to assignment shall not be unreasonably withheld. Part II closes with an analysis of why in many instances it is *mutually* beneficial to restrict assignment when assignment can be expected to do substantial harm to the non-assigning party even though the assigning party may gain from that assignment.

Part III treats in detail the first three considerations that lead parties to restrict assignment, which fall under the rubric that the value or cost of actual performance may vary from promisor to promisor or from promisee to promisee. It goes through each consideration — unspecifiable desired performance, different costs of inducing performance from different parties, and the bearing of non-conduct-based risk — and illustrates each with numerous

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<sup>8</sup> See generally Dimatteo, *supra* note 6; FARNSWORTH, *supra* note 6, §§ 11.4, 11.10.

<sup>9</sup> The examples are taken from a mix of sources: predominantly from the facts reported in cases, but also from contracts that I or people around me have encountered in daily life, various secondary sources, and the Internet.

<sup>10</sup> The case law also includes bankruptcy cases under § 365 of the Bankruptcy Code, which prevents a trustee or debtor-in-possession from assuming or assigning an executory contract if “applicable law excuses a party . . . from accepting performance from or rendering performance to an entity other than the debtor.” 11 U.S.C. § 365(c)(1) (2000). The analysis imports the default rule analysis of contract law, and they are treated interchangeably here.

examples, considering in each case why parties may or may not want assignability. Part IV describes the two factors leading to restricted assignability that do not directly relate to the cost or value of the promised performance — price discrimination and the administrative cost of assignment — illustrating with examples. Part V concludes.

## **I. The Law in the United States**

As a matter of contract default rules, contract rights can generally be assigned, and contract obligations can generally be delegated to others.<sup>11</sup> Doctrinally, there are separate exceptions to this general rule for the assignment of contract rights and the delegation of contract duties. The doctrines are similar, but worded differently; and while the standard for the delegation of duties seems to focus on the nature of the contract and promise to be performed, the standard for allowing assignment of rights seems to focus more on the burden imposed on the non-assigning party in any given assignment.

### **A. Assignment of Performance Obligations: “Personal Service Contracts”**

In the assignment (often termed “delegation”) of performance obligations, the general default rule is that performance obligations are not assignable “only to the extent that the obligee has a substantial interest in having that person perform or control the acts promised.”<sup>12</sup> The general implementation of this standard is the prohibition on delegation of “personal service contracts.”<sup>13</sup> What constitutes a “personal service contract” is relatively ill-defined in the case

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<sup>11</sup> See, e.g., *West Coast Cambridge, Inc. v. Rice*, 584 S.E.2d 696, 700 (Ga. Ct. App. 2003) (“contract rights and duties are generally assignable and delegable”); *Cason v. Conoco Pipeline Co.*, 280 F. Supp. 2d 1309, 1317 (N.D. Okla. 2003) (“Oklahoma courts have recognized a presumption of assignability for rights under a contract unless the parties expressly provide otherwise.”); *Vinson & Elkins v. Moran*, 946 S.W.2d 381, 394 n.7 (Tex. App. 1997) (“In general, all contracts are assignable.”); *Sys. Council EM-3, AFL-CIO v. AT&T*, 972 F. Supp. 21, 40 n.37 (D.D.C. 1997) (“It is a well-settled principle that, unless otherwise agreed by the parties, contract obligations may be delegated to a third party.”); RESTATEMENT (SECOND) OF CONTRACTS § 318(1) (1981) (“An obligor can properly delegate the performance of his duty to another unless the delegation is contrary to public policy or the terms of his promise.”); *Id.* § 317(2) (“A contractual right can be assigned unless . . .”).

<sup>12</sup> RESTATEMENT (SECOND) OF CONTRACTS § 318(2) (1981). The U.C.C. adopts nearly identical language. See U.C.C. § 2-210(1).

<sup>13</sup> E.g., *Sisco v. Empiregas, Inc.*, 237 So. 2d 463, 466 (Ala. 1970) (“personal service contracts are not assignable”); see FARNSWORTH, *supra* note 6, § 11.10, at 744 (“One of the most significant of [the substantial-interest] circumstances is the extent to which the performance is ‘personal’ . . .”).

law;<sup>14</sup> courts' "specifications" of this general standard include identification of "trust" or "confidence" in the other party;<sup>15</sup> reliance upon special "skill," "knowledge," "expertise," "unique talent," or "qualifications;"<sup>16</sup> and, sometimes, "credit."<sup>17</sup>

The application of some of these terms is relatively ad hoc, and they are not clearly separated. Trust sometimes appears to simply mean a trusting in how the counterparty will do something of importance to you. For example, one court held that an employment contract with covenant not to compete was not assignable by the employer on "personal confidence" grounds because the contract "permit[ted] the employer to discharge the employee . . . and then to prevent him for five years from pursuing his livelihood over . . . [that] encompass[es] some 7,850 square miles. Surely, one would not be presumed to have intended to commit himself into the hands of a stranger so empowered . . . ."<sup>18</sup> Similarly, a court noted that "[a] contract to build a home is . . . a contract for personal services which entails trust and confidence in the builder who is to undertake *such an important endeavor* for his customers."<sup>19</sup> Another court held that partnership agreements are based upon "personal trust and confidence," and that therefore limited partners

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<sup>14</sup> See Dimatteo, *supra* note 6, at 418, 424 (noting that some of the terms used have become "buzzwords whose real meanings have become unquantifiable" and that "courts have been unwilling to rationalize the many inconsistencies which have developed in this area of assignments).

<sup>15</sup> See Conference Am., Inc. v. Telecomms. Co-op Network, Inc., 1021047, 2003 WL 22753446, \*3 (Ala. Nov. 21, 2003) ("relationship of personal confidence"); Board of Tr. of Mich. State Univ. v. Research Corp., 898 F. Supp. 519, 522 (W.D. Mich. 1995) ("Personal contracts are those involving a personal trusts in a party or the special skills and knowledge of a particular individual or group of individuals.").

<sup>16</sup> See W. Coast Cambridge, Inc. v. Rice, 584 S.E.2d 696, 700 (Ga. Ct. App. 2003) ("Thus, certain classes of contracts are inherently non-assignable in their character, such . . . engagements for *personal services, requiring skill, science, or peculiar qualifications.*" (emphasis added)); Corell v. Teamsters Local Union No. 828, No. 00-1098, 2002 WL 31018534, \*2 (Iowa Ct. App. Sept. 11, 2002) ("A contract for personal services contemplates performance of duties involving the exercise of special knowledge, judgment, taste, skill, or ability."); In re Da-Sota Elevator Co., 939 F.2d 654, 656 (8th Cir. 1991) ("Unique talent is involved; the performers are not fungible.").

<sup>17</sup> See Financial Services of Puget Sound, Inc. v. Phenneger & Morgan, Inc., No. 41577-8-I, 1999 WL 1081267, \*4 (Wash Ct. App. Nov. 29, 1999) ("[A] contract that depends "on the integrity, credit, or responsibility of a party, or that confidence or trust is reposed in him [or her] personally for its performance, is not assignable[.]" (second and third alterations in original)).

<sup>18</sup> *Sisco v. Empiregas, Inc. of Belle Mina*, 237 So. 2d 463, 466 (Ala. 1970).

<sup>19</sup> *Craft Works Const., Inc. v. Nest*, No. Civ.A. RE-03-012, 2003 WL 22765942, at \*2 (Me. Super. Ct. Nov. 14, 2003).

did not have to accept the performance of a general partner other than the one with whom they originally made their investment.<sup>20</sup>

Some courts appear to highlight the dimension of actual personal interaction.<sup>21</sup> One court combined the “personal trust” and “skill” rubrics to state that sales representative employees of a software company had a non-assignable employment contract with the company because their “prior experience, in addition to the nature of their employment and direct interaction with [the company’s] customers,” demonstrated “personal trust and . . . special skills.”<sup>22</sup> In contrast, one court noted that a telecommunications service provider could assign its performance to another because the contract did “not involve . . . a personal relationship; rather, this case involves the performance of an agreement by the unidentified agents, servants, or employees of an impersonal corporation to provide teleconferencing services to customers of another impersonal corporation.”<sup>23</sup> Similarly, a court examining an “Agreement for Garbage Hauling and Disposal,” noted that “it appears that *personality is not an essential consideration* and that only the certain object or result is contracted for and not the personal labor or services of the promisor.”<sup>24</sup>

Other courts emphasize “skill and expertise,” tending to hold contracts to be assignable by default if the level of skill possessed by the promisor is typical of others in the market that are readily available. One court held that a party could assign its performance under an elevator maintenance contract, noting that despite that while “skilled workmanship and sound management practices are conducive to success” and that “customers turn to Mr. Benson with confidence,” in the end “elevator maintenance is a more routine commercial function. . . . There are many competent competitors in the North Dakota market.”<sup>25</sup> Similarly, a court noted that a subcontract was assignable because it was not dependent upon “special knowledge or unique skill or talent possessed only by [the party]. There is no reason that the Subcontract could not be

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<sup>20</sup> In re Harms, 10 B.R. 817, 821 (Bankr. D. Colo. 1981).

<sup>21</sup> See Public Svc. Comm’n of Md. v. Panda-Brandywine, L.P., 825 A.2d 462, 470 n.4 (Md. 2003) (“when personal relations are important, a person cannot be compelled to associate with another person”).

<sup>22</sup> Logical Networks, Inc. v. Murdock, No. 239779, 2002 WL 31187877, at \*3 (Mich. App. Oct. 1, 2002).

<sup>23</sup> Conference Am., Inc. v. Telecomms. Co-op Network, Inc., No. 1021047, 2003 WL 22753446, at \*3 (Ala. Nov. 21, 2003).

<sup>24</sup> Waste Connections of Neb., Inc. v. Great Plains Recycling, Inc., No. CI00-86, 2002 WL 31056578, \*2 (Neb. Dist. Ct. Jan. 13, 2002).

<sup>25</sup> In re Da-Sota Elevator Co., 939 F.2d 654, 656 (8th Cir. 1991).

performed by another computer software company.”<sup>26</sup> The skills of a office secretary were said to be non-unique and thus the employment contract assignable,<sup>27</sup> and a contract to excavate a specified amount of sand from property, the amount to be determined by the landowner, was said to involve little particular skill or ability.<sup>28</sup> At the other end of the spectrum, courts have noted that contracts non-assignable because they require “the exercise of knowledge, judgment, or skill” include “a contract to furnish an abstract of title” and “a contract to render professional services as a physician, lawyer, or architect.”<sup>29</sup> The “specific expertise” of a particular artist is cited as a reason to disallow assignment of performance obligations by musicians and other artists.<sup>30</sup>

So the (very) rough trend is that the more that personal relationships are involved, and the less reliably the same performance can be procured in the market, the more likely it is that the performance will not be deemed delegable. One court has gone a slightly different route, noting that the process of choosing a counterparty is important: “In a contract in which one party selects the other . . . through the exercise of discretion based upon the qualifications and fitness of the selected party, the selected party may not assign the contract at his pleasure.”<sup>31</sup>

One final default rule about assignment of contract performance is that even if an assignment is effective and valid, the assigning performer is not off the hook for the required performance — it merely permits another to satisfy the performance obligation. The *Restatement* declares that “[u]nless the obligee agrees otherwise, neither delegation of

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<sup>26</sup> *In re Fastrax, Inc.*, 129 B.R. 274, 278 (Bankr. M.D. Fla. 1991).

<sup>27</sup> *See Corell v. Teamsters Local Union No. 828*, No. 00-1098, 2002 WL 31018534, at \*3 (Iowa Ct. App. Sept. 11, 2002) (“The skills the district court found Correll performed as office secretary are not unique or nondelegable.”).

<sup>28</sup> *See Earth Prods. Co. v. Okla. City*, 441 P.2d 399, 404 (Okla. 1968) (noting that there was no evidence of “trust and confidence” placed in the contractor to perform the obligations, and that the contractor’s “obligations to retain and maintain slopes, banks, and excavations within stated limits . . . are so menial in character that they can as easily be performed by one person as another, and there appears to be no special skill or ability involved.”).

<sup>29</sup> *Baker v. Conoco Pipeline Co.*, 280 F. Supp. 2d 1285, 1295 (N.D. Okla. 2003).

<sup>30</sup> *See In re Da-Sota Elevator Co.*, 939 F.2d 654, 655–56 (8th Cir. 1991).

<sup>31</sup> *L.V. McClendon Kennels, Inc. v. Investment Corp. of S. Fla.*, 490 So. 2d 1374, 1376 (Fla. App. 1986).

performance nor a contract to assume the duty made with the obligor by the person delegated discharges any duty or liability of the delegating obligor,”<sup>32</sup> and courts regularly apply this rule.<sup>33</sup>

## **B. Assignment of Contract Rights**

The Restatement’s rule for the assignment of contract *rights*<sup>34</sup> is that they can be assigned unless the assignment “would materially change the duty of the obligor, or materially increase the burden or risk imposed on him by his contract, or materially impair his chance of obtaining return performance, or materially reduce its value to him.”<sup>35</sup>

This standard has been adopted by courts.<sup>36</sup> For example, some courts have held that purported assignments of covenants not to compete from the original employer to another business were invalid under the “material change in duty” rubric when the assignment could substantially weaken the employees’ ability to find employment;<sup>37</sup> but one court has held the

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<sup>32</sup> RESTATEMENT (SECOND) OF CONTRACTS § 318(3) (1981); *see also* U.C.C. § 2-210(1) (“No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.”).

<sup>33</sup> *See, e.g.,* Morris Silverman Mgmt. Corp. v. W. Union Fin. Svcs., Inc., 284 F. Supp. 2d 964, 983 (“Except to the extent provided in the Agreement or consented to by Western Union, delegating its obligations did not discharge MSMC’s duty.”); Transp. & Transit Assocs., Inc. v. Morrison Knudsen Corp., 255 F.3d 397, 399 (7th Cir. 2001).

<sup>34</sup> For a background discussion of default rules regarding the assignability of contract rights, *see generally* FARNSWORTH, *supra* note 6, § 11.4, at 713–18.

<sup>35</sup> RESTATEMENT (SECOND) OF CONTRACTS § 317(2)(a) (1981). Also, assignments cannot be made if they are forbidden by statute or public policy; or if the contract itself makes the rights nonassignable. *Id.* § 317(2)(b)–(c). The Uniform Commercial Code adopts the same standard as the Restatement, stating that a purported assignment of rights under a contract for the sale of goods is ineffective if it would “materially change the [obligor’s] duty,” “increase materially the burden or risk imposed on him by his contract,” or “impair materially his chance of obtaining return performance.” U.C.C. § 2-210(2).

<sup>36</sup> *See, e.g.,* Cedar Point Apartments, Ltd. v. Cedar Point Inv. Corp., 693 F.2d 748, 753 (8th Cir. 1987) (considering whether there was a “material change in the sellers’ duty to convey title to the realty or chance of receiving return performance occurred by [the] assignments”); Delacroix v. Lublin Graphics, Inc., 993 F. Supp. 74, 81 (D. Conn. 1997) (adopting the Restatement test for assignability of contract rights); Hess v. Gebhard & Co., 808 A.2d 912, 922 (Pa. 2002) (“[A]n assignment of a right will not be effective if it purports to make a material change in the duties or responsibilities of the obligor, unless the obligor assents to such changes.”).

<sup>37</sup> *See, e.g.,* Hess, 808 A.2d at 922 (holding an assignment of an employee’s covenant not to compete to a successor business to the original employer to be invalid because “the assignment makes a material change in Hess’ obligations,” in that “[h]e is foreclosed from competing on any level with a much larger business entity”); Allegheny Anesthesiology Assocs., Inc. v. Allegheny General Hosp., 826 A.2d 886, 892–93 (Pa. Super. Ct. 2003) (suggesting that “enforcement of the non-compete covenants would have

assignment of the purchaser's right under a real estate sales contract to be valid because it did not work "a material change in the seller's duty to convey title to the realty,"<sup>38</sup> and another court has held that the rights of a hospital owner to receive a physician's obligations to it (such as to remain licensed, and in good standing, and to maintain a full-time practice at the hospital) could be assigned to a new owner of the hospital assets because the physician's obligations did not change.<sup>39</sup> Several courts have held that purported assignments of the right to receive payments under structured settlement agreements were invalid under the "material increase in burden or risk" rubric because it would subject the non-assigning party to unfavorable or more uncertain tax treatment;<sup>40</sup> while a court validated an assignment of Amoco oil's assignment of franchise agreements with dealers to Amoco jobbers, rejecting the dealers argument that the assignment increased the dealers' burden of risk and reasoning that the feared burdens — increase in gasoline prices and monthly rent — were both speculative and were rights that the original party, Amoco, could have exercised previously and were therefore not materially increased.<sup>41</sup> The assignment by an insured of rights under an insurance policy is a canonical example of a change in risk to the insurer where assignment could not be allowed.<sup>42</sup>

One apparent distinction between the assignment of rights and assignment of performance analyses is that the personal-service test looks at the nature of the contract rather than the nature of the particular assignment being challenged — a contract where performance

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materially altered the duties . . . of the [nurses] employed by [the anesthesiology association]" because the association was seeking to force them to discontinue their work with a hospital). Other courts have permitted the assignment of rights under a non-compete agreement to a successor business. *See W. Coast Cambridge, Inc. v. Rice*, 584 S.E.2d 696, 700 (Ga. Ct. App. 2003) ("Since it was only [Rice] who owed any further duty under the contract and since no personal confidences were involved in connection with the countervailing contractual right to enforce that duty, the instant case would come within the general rule of assignability of contract rights.").

<sup>38</sup> *Cedar Point Apartments*, 693 F.2d at 753.

<sup>39</sup> *See Feldstein v. Nash Community Health Svcs., Inc.*, 51 F. Supp. 2d 673, 677, 691 (E.D.N.C. 1999).

<sup>40</sup> *See, e.g., CGU Life Ins. Co. v. Singer Asset Finance Co., LLC*, 553 S.E.2d 8, 17 (Ga. Ct. App. 2001); *Cavallaro v. SAFECO Assigned Benefits Co.*, No. CV 990362118S, 1999 WL 1126320, \*8–9 (Conn. Super. Ct. Nov. 18, 1999).

<sup>41</sup> *See Beachler v. Amoco Oil Co.*, 112 F.3d 902, 908 (7th Cir. 1997).

<sup>42</sup> *See FARNSWORTH, supra note 6, § 11.4, at 717 (citing Central Union Bank v. N.Y. Underwriters' Ins. Co., 52 F.2d 823 (4th Cir. 1931)); cf. Waltman & Co. v. Leavitt*, 722 A.2d 862, 864 (Me. 1999) ("Insurance contracts are personal in nature; they do not run with the land.").

duties are “personal” are “per se” nonassignable.<sup>43</sup> In the context of assignment of *rights*, courts seem willing to look at the purported assignment and determine whether the particular assignment in question increases the burden or risk on the non-assigning party.<sup>44</sup>

But this distinction is sometimes blurred. This blurring comes along with an occasional blurring of the standards for assignment of rights and the standards of assignment for duties — courts sometimes preclude the assignment of either end of a contract on the grounds that the “contract” is personal in nature. One court has noted that “certain *rights and* duties under a contract are too personal in character to permit them to be assigned,”<sup>45</sup> and described as valid law an analysis of whether a purchaser’s *rights* under a gas supply contract were assignable that turned on a consideration of whether “skill, credit, or some other personal quality” was present,<sup>46</sup> a standard formally attaching to the assignment of performance obligations. Cases involving the assignment of covenants not to compete by the employer to the purchaser of an employer’s business, where the litigated issue is the assignment of the *right* to enforce the covenant after employee termination, often discuss the extent to which personal trust and confidence imbue the employment contract of which the covenant is a part.<sup>47</sup>

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<sup>43</sup> See *Sally Beauty Co. v. Nexxus Prods. Co.*, 801 F.2d 1001, 1008 (7th Cir. 1986) (“If [performance is a personal services contract], the duty is per se nondelegable. There is no inquiry into whether the delegate is as skilled or worthy of trust and confidence as the original obligor: the delegate was not bargained for and the obligee need not consent to the substitution.”).

<sup>44</sup> See *Cedar Point Apartments*, 693 F.2d at 753 (noting that the purchaser’s right under a real estate sales agreement did not work “a material change in the seller’s duty to convey title to the realty or chance of receiving return performance” and holding the assignment to be valid).

<sup>45</sup> *Beattie v. State ex rel. Grand River Dam Authority*, 41 P.3d 377, 381 (Okla. 2002)

<sup>46</sup> *Id.* at 381–82 (describing *Minnetonka Oil v. Cleveland Vitriified Brick Co.*, 111 P. 326 (Okla. 1910)).

<sup>47</sup> See, e.g., *Hess v. Gebhard & Co.*, 808 A.2d 912, 922 (holding that a covenant not to compete is not assignable to the purchaser of an employer because “the employment contract, of which the covenant is a part, is personal to the performance of both the employer and the employee, the touchstone of which is the trust that each has in the other”); *Sisco v. Empiregas, Inc. of Belle Mina*, 237 So. 2d 463, 467–68 (Ala. 1970) (holding that the right to enforce a covenant not to compete to be non-assignable because of the trust placed by the employee in his employer). The court in *In re Hearing Centers of America, Inc.*, 106 B.R. 719 (Bankr. M.D. Fla.) is somewhat ambiguous, noting that assignment of a personal services contract such as a building contract from a respected builder to an inexperienced one would be impermissible. *Id.* at 721. But it seems ultimately to rest its decision that a covenant not to compete was assignable on the nature of the contract: “the contract that the Debtors seek to assign contains a covenant which attempts to keep the employees from performing, rather than an attempt to assign the performance

Finally, it should be noticed that in certain instances, the law more jealously protects a party's ability to assign a contract *right* than it is to assign a contract obligation; particularly when it is a "bare" right not dependent on any obligation or conduct of the promisee. The Uniform Commercial Code, for example, invalidates clauses prohibiting the assignment of rights to payment for goods sold or services rendered,<sup>48</sup> and in a contract for the sale of goods, provides that "a right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise."<sup>49</sup> In the insurance context, moreover, "[t]he great weight of authority distinguishes between assignment of an insurance policy before a loss occurs and assignment after loss."<sup>50</sup> Many courts place at least a very strong default rule in favor of permitting the assignment of the right to collect proceeds after the loss occurred: "a clause restricting assignment [of the policy] does not in any way limit the right of assignment after the loss has occurred, and the rights of the parties become fixed thereby."<sup>51</sup> Some courts make this rule a mandatory one requiring post-loss assignability of the beneficiary's right.<sup>52</sup>

### **C. Discussion of the Legal Framework**

The legal framework does appear to capture most of the relevant considerations: the assignment of rights analysis takes into account the problem of assignments at the highest level of abstraction, harm to the non-assigning party, which can come in the form of increased cost of performance or increased risk being borne. The "personal service contracts" analysis in the assignment of obligations is relatively vague and conclusory, but its focus on such matters as unique skill and expertise, and even personal interaction correctly perceives half of the problem. Assignment is harmful to the non-assigning party, in cases of unspecified obligations, where there is *both* a range of contractually acceptable behavior because of the impossibility or

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of a personal service." *Id.* at 722. The court did *not* consider an individualized inquiry into whether the burden on the non-assigning party increased.

<sup>48</sup> See U.C.C. § 9-318(4)

<sup>49</sup> U.C.C. § 2-210(2).

<sup>50</sup> *Antal's Restaurant, Inc. v. Lumbermen's Mut. Cas. Co.*, 680 A.2d 1386, 1388 (D.C. App. 1996).

<sup>51</sup> *Id.*

<sup>52</sup> See, e.g., *Bolz v. State Farm Mut. Auto. Ins. Co.*, 52 P.3d 898, 906 (Kan. 2002) ("State Farm fails to state any . . . public policy exception to the general rule that post-loss assignments are valid even in the face of nonassignment clauses.").

costliness of fully specifying the desired conduct, *and* the possibility of assignment from a counterparty who will perform in the high end of that range, to one who will perform in the low end of that range. Thus it is the combination of flexibility in the contract and uniqueness in the performer that matters.

The framework also has shortcomings. It neglects the fourth and fifth considerations for restricting assignment: price discrimination and the administrative cost of assignment; and moreover in the realm of unspecified obligations and personal service contracts does not seem to be aware of the possibility that assignment could be harmful aside from the characteristics of one particular counterparty but merely because it is important that the counterparty remain the same. Finally, though it blurs the distinction at times, the doctrinal frameworks for analyzing assignment of rights and assignment of obligations are artificially separated, although the two cases are largely symmetrical. This Article, while it does not give much attention beyond this point to courts' reasoning, seeks to overcome these shortcomings.

## **II. The Analytical Model**

This Part provides an analytical model demonstrating the parties' economic considerations when they are writing contracts and considering whether to permit or prohibit assignment by one or both parties; or whether to permit certain kinds of assignments by one or both parties.

### **A. Assigning Rights and Obligations**

A promisee in some contractual relationship values his contractual rights a certain amount; and will encounter, with some probability, a person who values the promise more than the promisee does, and who thus is willing to pay some premium to the promisee.<sup>53</sup> This could be because the promisee's valuation of his contract rights has fallen. For example, a franchisee may discover that she doesn't like running a McDonald's shop, making the franchise agreement less valuable to her; a gas station with a contract to buy gasoline may find its retail market evaporated; or a person leasing an apartment loses her job and must move to a different city, making her current lease almost worthless. Alternatively, it could be because the promisee

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<sup>53</sup> Cf. Note, Daniel A. Wilson, *Patent License Assignment: Preemption, Gap Filling, and Default Rules*, 77 B.U. L. REV. 895, 921 (1997) (noting that patent licensees "value the ability to sell the license when it is worth less to them than to a potential buyer").

encounters someone who simply values the contract rights more — an experienced franchisee seeking to expand her operations; a company that can do something else with the gasoline; or an individual who loves the lessee’s apartment because of its view.

Should the promisee assign the contract, harm may be inflicted upon the promisor. This harm may be negligible if the assignee is in all relevant ways the same as the assignor. But there could be positive harm for a number of reasons: principally, if the assignee costs more for the promisor to perform for. For example, the new franchisee may be a bad businessperson and franchisor royalties decline; or the new tenant in the apartment is noisy and thus makes it harder to rent out neighboring apartments. The harm caused by the assignment could conceivably be negative (i.e., the assignment benefits the non-assigning promisor) if the assignee costs less to perform for: the new franchisee may be very good; the new tenant may be quiet and take care of the apartment.

The above analysis was for assigning contract rights. The same applies for assigning contract obligations: a promisor “values” his obligation to perform a certain amount, and with some probability will encounter a potential assignee who “values” that obligation more, and who will thus pay some premium for the additional value.<sup>54</sup> This may occur because the promisor’s situation has changed — something may have made it very costly for the initial promisor to perform<sup>55</sup> — or it may simply be that the potential assignee can perform cheaply. And the non-assigning promisee could be harmed by an assignment: there could be positive harm if the assignee promisor’s performance is worse; the harm could be negative if the performance is better.

Thus, in either context, the value to a potential assigning party of having a contract permit assignment is the *premium* to be paid by someone who values the assignor’s end of the contract more than the assignor does; discounted by the *probability* that such a someone will be found. Meanwhile the cost to the non-assigning party of allowing assignment is the *harm* caused by the transfer to the new party, discounted by the *probability* that the transfer will occur. The parties will contract to maximize the sum of their expected values — the size of the pie to be

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<sup>54</sup> The “value” will presumably be negative in the sense that it will generally cost the promisor something to perform; a potential assignee who “values” it more is someone who can perform at a lower cost.

<sup>55</sup> This can include opportunity cost: a person who promised to do a job at low pay might have received an offer to do the same work for three times the money.

shared. Thus, assuming costless contracting, they will assignment if the benefit of assignability to the assigning party exceeds the cost to the non-assigning party of assignability — that is, if (*premium* x *probability*) exceeds (*harm* x *probability*). Simplifying, the contract will be made assignable if the premium to be paid to the assignor by the higher-valuing assignee exceeds the harm from assignment to the non-assigning party.

Note that in the real world, there are default rules for contracts and it is costly for parties to flip out of the default. If the default rule is nonassignability, then we will expect to see a term permitting assignment if the net benefit from permitting assignment — *premium* to assigning party minus *harm* to non-assigning party (this difference discounted by the probability of assignment) — exceeds the transaction cost. Conversely, if the default rule is that assignment is permitted, then forbidding assignment will have a nonzero transaction cost, and we would expect to see a provision forbidding assignment if the benefit from preventing assignment — the *harm* to the non-assigning party prevented minus the *premium* to the assigning party foregone (this difference discounted by the probability) — exceeds the transaction cost.

### **B. Partial Restrictions on Assignment**

The assumption of the previous section — that there is a single kind of assignment to a single type of assignee who will value the assigned contract at a given premium more than the assignor, and that a single value — is not accurate. There are a variety of possible assignments to assignees who value the contract differently (if the rights are being assigned, different assignees could value those differently; if the obligations are being transferred, different assignees could have different costs). And transfers to different assignees could impose different harms on the non-assigning party.

Thus, if the choice is simply between permitting assignments and prohibiting them, the parties need to make an aggregate assessment whether the net excess of premiums over harms for good assignees (premium they would pay to the assignor would exceed the harm to the non-assigning party) exceeds the net excess of harms over premiums for bad assignees (harm imposed on non-assigning party would exceed the premium that assigning party would receive).<sup>56</sup> Roughly speaking, if most assignees would give a high premium to an assigning

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<sup>56</sup> Note the figures for each assignee must be weighted by the probability of an assignment happening to that assignee.

party and inflict little harm on the non-assigning party, permitting assignment generally will maximize value; if most assignees are more harmful, prohibiting assignment will be value-maximizing.

Ideally, however, a contract would permit assignments to higher-premium-than-harm assignees, while preventing assignments to lower-premium-than-harm assignees. There are several contracting techniques for attempting to sort the good from the bad assignees.

One method, an alternative to assignability clauses, is to increase the specificity of the actual performance obligations of the potential assigning party. It may be possible to limit harm to the non-assigning party if the specific obligations can be enforced, effectively making the assignee a more perfect substitute for the original contracting party.

A more strictly assignment-oriented method is to specify a set of permissible assignees. This can be done by identifying a list of permissible assignees by identity or relationship to the contracting party. For example, investors may enter a financial services agreement with an investment bank in order to gain the services of a particular banker, and desire that the investment bank's interest in the contract be assignable to future employer of that banker.<sup>57</sup> One party with a complex corporate structure may value organizational flexibility; yet an employee or contractor may not be harmed by having his employment or other contract moved about within the large corporate umbrella or having the company contract with change corporate form from a partnership to a corporation.<sup>58</sup> Thus a contract may permit assignment only to affiliates of one of the original contracting parties.<sup>59</sup> These techniques are likely to limit harm from assignment:

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<sup>57</sup> See, e.g., *Holland v. Fahnestock & Co., Inc.*, 210 F.R.D. 487 (S.D.N.Y. 2002) (“Fahnestock may not assign its rights and/or obligations . . . without the consent of Owner, except to one or more affiliates of Fahnestock. Notwithstanding the foregoing, David Pullman may at his sole discretion . . . cause Fahnestock to assign its rights and/or obligations . . . to David Pullman, or any entity which employs David Pullman . . .”).

<sup>58</sup> Cf. *Dimatteo*, *supra* note 6, at 433 (noting that the general default is that “a change in the corporate form does not prevent the assignment of contracts held by the predecessor corporation”); *Alexander & Alexander, Inc. v. Koelz*, 722 S.W.2d 311, 313 (Mo. Ct. App. 1986) (“[A] change in the form in which the employer does business . . . while involving a formal transfer from one entity to another, should not be seen as creating an assignment in violation of the rule against the assignment of personal service contracts. The merger here . . . had no [e]ffect on the business of the employer, which was merely converted from a wholly-owned subsidiary . . . to an integral corporate part . . .”).

<sup>59</sup> See, e.g., *id.*; *Cinicola v. Scharffenberger*, 248 F.3d 110 (3d Cir. 2001) (discussing contracts between physicians and a healthcare system that specified: “No assignment of this Agreement or the rights or

non-assigning parties can list potential assignees who will do just as good a job as the original counterparty; and corporate affiliates are likely to be similar (or identical) in financial and personnel characteristics.

Another possibility is to restrict assignment to an entity that is the successor of the assignor's business.<sup>60</sup> Note that the harm to the non-assigning party is likely to be low. If an entire business is purchased, many of that business's characteristics — its employees, expertise, methods of operation — will be largely continuous.<sup>61</sup> This partial permission may also identify a subset of transactions where the assigning party can get a sizable premium from a buyer since a going concern may be much more valuable with an important contract than without it.

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obligations hereunder shall be valid without the . . . consent of both parties . . . , except that this Agreement may be assigned by MCP-HU or AIHG to any parent, subsidiary, or affiliated corporation without prior approval of [the] Physician”).

<sup>60</sup> For example, in *Cyrix Corp. v. Intel Corp.*, 803 F. Supp. 1200 (E.D. Tex. 1992), Intel provided a technology license to Mostek for a one-time royalty payment; the license agreement stated that the license could be assigned without consent to a successor in ownership of “all or substantially all the assets of the assigning party.”

In *Hess Energy, Inc. v. Lightning Oil Co., Ltd.*, 276 F.3d 646 (4th Cir. 2002), a master agreement for natural gas purchases read:

Neither Party shall assign this Agreement or any of its rights, duties or obligations hereunder unless it shall have first obtained the consent in writing of the other Party hereto, which shall not be unreasonably withheld . . . , provided however that either Party may without the consent of the other . . . transfer or assign this Agreement to any successor, representative or assignee which shall succeed by purchase, merger or consolidation to the properties, substantially as an entirety, of Seller [Lightning] or Buyer [Statoil] . . . .

*Id.* at 648. In *Proteon, Inc. v. Digital Equipment Corp.*, 1999 WL 1336438 (Mass. Super. Ct. Jan. 13, 1999), a software license agreement allowed certain kinds of assignment if the licensee transferred all or part of its networking business. *See id.* at \*5 (“Digital may fully assign its rights hereunder in connection with a transfer of all its internetworking business or a product line thereof to a third party, retaining only rights in the Licensed Technology sufficient to support . . . the then installed base of Products . . . .”).

Finally, one commentator notes that while author-publisher contracts are typically not assignable, publishers often reserve “the right to assign without the author’s consent if there is a transfer of all or substantially all of the publisher’s assets.” Martin P. Levin, *A New Guide To Negotiating the Author-Publisher Contract*, 6 CARDOZO ARTS & ENT. L.J. 411, 44 (1988).

<sup>61</sup> *Cf.* 9 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 884 (Joseph M. Perillo ed., 2002) (“[A] contract to supply the needs and requirements of a specific factory, plant, or going concern is one where the extent of the performance is usually not dependent upon the personality of the owner who makes the contract.”).

Relatedly, permitting assignment for sales of businesses grants the seller the ability to take advantage of potential buyers who value both the contract and the entire business more than he does. The sale of businesses often requires transferring many contracts to a purchaser. Requiring the seller to get consent from its contracting partners may give those partners the ability to stall the transaction as holdouts.<sup>62</sup> Preventing this holding out by allowing free assignment thus enables these valuable-to-the-assignor transactions to occur.

Limiting the set of permissible assignees to minimize harm to the non-assigning party can also be done by specifying criteria that any assignee must meet. Such criteria are likely to be those that informed the initial choice of a contract partner. Thus, one may use use-based restrictions: assignment of a contract may be made only to someone in a certain kind of business who will use the contract in a particular way.<sup>63</sup> Or there may be financial or business suitability criteria: where a contract party such as a franchisee requires serious business acumen, assignment (like initial selection) might be limited only to those with enough sophistication as evidenced by their financial profile.<sup>64</sup>

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<sup>62</sup> Cf. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 3.8, at 61 (6th ed. 2003) (describing that if one party needs consent of multiple counterparties is required to complete a transaction, those counterparties will seek to delay granting their consent to enable them to become a “holdout” and extract substantial value from the party doing the transaction; and thus add substantial delays and transaction costs threatening the transaction’s consummation).

<sup>63</sup> See, e.g., *City of Va. Beach v. Christopolous Family, L.C.*, 52 Va. Cir. 95 (2000) (describing a ground lease between the city and a developer of beach hotel property that provided that “the rights and obligations of Developer . . . cannot be assigned by Developer without the prior written consent of the City and Authority, which shall not be unreasonably withheld;” except that “Developer may assign its rights and obligations . . . to an Affiliate and to an Acceptable Hotel Franchisor without the prior written consent of City and Authority” (emphasis added)).

<sup>64</sup> For example, in *Perez v. McDonald’s Corp.*, 60 F. Supp. 2d 1030, 1032–33 (E.D. Cal. 1998), the court described a franchise agreement between McDonald’s and one of its franchisees that stated:

Licensee shall not sell, transfer, or assign this License to any person or persons without Licensor’s prior written consent. Such consent shall not be arbitrarily withheld.

In determining whether to grant or to withhold such consent, Licensor shall consider of each prospective transferee, by way of illustration, the following: (i) work experience and aptitude; (ii) financial background, (iii) character, (iv) ability to personally devote full time and best efforts to managing the Restaurant, (v) residence in the locality of the Restaurant, (vi) equity interest in the Restaurant, (vii) conflicting interests, and (viii) such other criteria and conditions as Licensor shall then apply in the case of an application for a new License to operate a McDonald’s restaurant.

Finally, consent from the non-assigning party might be required, but the contract may state that consent shall not be unreasonably withheld.<sup>65</sup> Note this defers the definition of the set of permissible assignees and the criteria for assessing them until the time of an attempted assignment, and then only if the withholding of consent causes a conflict.

Each method to confine the set of possible assignees comes at some cost. This cost comes in two forms: First, there are up-front specification costs of writing the partial-restriction provisions, which are borne for certain. Second, there are enforcement and litigation costs that can arise when there is a dispute later about whether the requisite conditions have been met, which are borne with some probability (i.e., only when there is a dispute). If a list of acceptable assignees is specific or the criteria are straightforward (e.g., affiliates of assignor; or detailed financial test), enforcement costs are likely to be small. Defining the set of permissible assignees by a more open-ended standard, or merely using reasonableness, may reduce the costs of up-front contracting but increase the probability of a dispute over the appropriateness of an assignee under the standard. Vague standards will also increase the cost of litigating or otherwise resolving that dispute.

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McDonald's asserted and the court approved the consideration of completion of the McDonald's franchising training course as a necessary qualification as a franchise assignee. *See id.* at 1034.

<sup>65</sup> *Richter v. Dairy Queen of Southern Arizona, Inc.*, 643 P.2d 508 (Ariz. 1982), revealed that assignment of Dairy Queen franchise agreements by franchisees was subject to this standard:

Licensee agrees that the interest of Licensee hereunder may not be transferred, assigned or alienated in whole or in part without the written consent of Company . . . , *which consent shall not be withheld unreasonably*, but Company may insist that any proposed assignee be a person, in Company's judgment, qualified to provide active supervision over the operation of said 'Dairy Queen' store in said territory in compliance with Licensee's obligations therefor hereunder.

*Id.* at 509.

*Hannex Corp. v. GMI, Inc.*, 140 F.3d 194 (2d Cir. 1998), involved a distribution agreement between a maker of underwater cameras and a United States distributor of those cameras. The agreement was “assignable by either party with the consent of the other, which consent could not be unreasonably withheld.” *Id.* at 197; *see also Quality Healthcare Equipment, Inc. v. Lumex, Inc.*, No. 96 C 4847, 1996 WL 604059, at \*1 (N.D. Ill. Oct. 18, 1996) (describing a distribution agreement between maker of air loss therapy bed systems and distributor that stated: “Neither party to this Agreement may assign its obligations hereunder without the prior written consent of the other, which consent shall not be unreasonably withheld”).

These contracting and enforcement costs of using one of these partial restrictions is likely to be greater than the costs of either permitting or banning assignment altogether.<sup>66</sup> Thus, there is a tradeoff here: incurring more contracting and dispute-resolution costs to partially restrict assignment is more likely to selectively permit desired assignments and preclude undesired assignments. Cheaply going all-or-nothing, meanwhile, will harm the parties because it will either prohibit some assignments of net positive value or permit some assignments of net negative value.<sup>67</sup>

### **C. Focus on Harm**

The rest of this Article proceeds with factors supporting assignment restrictions principally in cases where the harm to the non-assigning party is likely to be great. This does not by itself establish that prohibiting assignment is likely to be suboptimal. This is because a contract term should appear only when it is *mutually* beneficial to the parties: whether assignment is beneficial depends both on the harm to the non-assigning party and the value the assigning party gets from the assignment.

Identifying situations in which a substantial harm to the non-assigning party is likely, however, should provide a first approximation of when restricting assignment is likely to be mutually beneficial. First, in many contracts, the value of the contract to an assignee (and thus the value that an assigning party will receive by assigning his end of the contract) may be at least partly independent of the harm to the non-assigning party. An example of this may be a lease: how a person values a lease may vary based on where she works or if she likes the nearby restaurants. Variations among lessees on these dimensions will not alter the landlord's costs, which depend on how noisy a tenant is and how well she takes care of the place. For contracts where there is independence between harm to non-assigning party and benefit to assigning party

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<sup>66</sup> This may be the case even when the default rule is itself a partial restriction on assignment — as in the contract rights context where assignments that materially increase the burden on the non-assigning promisor are not permitted — because by incurring extra up-front costs to make the contract either assignable or non-assignable, the parties may save on enforcement and litigation costs later on.

<sup>67</sup> This Article does not finely parse partial restrictions on assignability or the existence of different possible assignees: rather, it merely seek to explore the reasons that may make a substantial number of potential assignments of a contract undesirable and will conclude that restrictions on assignment of some kind in such instances are likely to be desirable. Partial restrictions on assignment are pointed out as they arise.

exists, the more likely significant harm is to occur to the non-assigning party, the less likely it is that any particular assignment will generate enough premium for the assignor to compensate for that harm.

Second, in many contracts, the assignee's valuation of the contract (and thus the premium to the assignor) tracks the amount of harm to the non-assigning party. An example is insurance policies: a high-risk person's valuation of an insurance policy should exceed a low-risk person's valuation of that policy by approximately the additional expected loss that the high-risk person will suffer. By the same token, the assignment harms the insurer because of the same incremental expected loss.<sup>68</sup> In such cases, we should ask whether a promisee, for instance, would prefer to get a discount based on his low cost to the promisor, or pay more for being able to resell.<sup>69</sup>

It is likely that such promisees will prefer to take the discount. Why? In some cases, the issue is one of transaction costs and specialization — the (assume non-assigning) promisor under a contract is in the business of selling a certain kind of promises (e.g., insurance coverage), while the (potentially assigning) promisee requires such a promise as an input (e.g., needs one insurance policy). If there is someone who would value the promise highly (a higher-risk person who wants insurance), it is more efficient for that person to go directly to the entity who is in the business of selling such promises (the insurance company) rather than an isolated other customer of that promisor who is inefficient at the business of selling that promise (and who, unless he has decided to enter the contract resale business, will then have to buy another promise for himself anyway). Thus, preventing assignment even in the case of correlation is an allocation of selling

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<sup>68</sup> Similar are financing agreements. A person with bad credit (and only able to borrow at high interest rates) would be willing to pay a premium to be able to take over a good-credit person's low interest rates — and this premium may be as high as the difference in the interest rates. However, the transfer from a good-credit person to a bad-credit person should harm the lender (by increasing the risk of default) in an amount about equal to the value of the difference in interest rates (because interest rates differ because of different risks to the lender).

<sup>69</sup> Thus we ask whether a non-smoker buying an insurance policy would prefer to buy a cheap insurance policy to insure himself, or buy a more expensive insurance policy where he is able to transfer it to a smoker.

and distribution to the party who usually can perform those tasks at the lowest cost — usually the non-assigning party.<sup>70</sup>

Also, even when there is a correlation between harm to non-assigning party and value of the contract to the assignee, prohibitions on assignment are likely because they overcome a pricing and market pooling problem similar to adverse selection in insurance. Facing a group of promisees who may assign their contract rights to others, a promisor will charge each of them slightly higher, based upon the probability that those promisees will assign the contract to a less desirable assignee. However, among that group of promisees, there will usually be some who are less likely than average to assign their contract — perhaps because they have an idiosyncratic valuation of the contract, perhaps because their business or life simply requires them to have that contract, or perhaps they prefer or are better at using their contract rights than they are at selling them — but are not able to signal this effectively to the promisor to get a discount. So, these promisees are less costly to the promisor than some of their potential assignees, but if they are permitted to assign the contract, they are not able to take full advantage of this cost. Assuming that the promisor will charge enough to cover his expected costs, prohibiting assignment is mutually beneficial because it permits the promisee to take full advantage of his superiority over other promisees. Once these less-likely-to-assign parties take their discount and agree not to assign, however, the remaining group's average probability of assignment will increase. The same analysis will iterate until all promisees will agree not to assign, with the exception of those who are certain to assign (and these are sales agents, not users of the contract).

Thus, we see that in many contexts, the more likely it is that the non-assigning party will incur a substantial harm because of an assignment, the more likely it is to be mutually beneficial to prohibit assignment. Note one exception to this general rule is situations in which changes in one party's circumstances are likely to substantially reduce that party's valuation of the contract over time. An example of this may be long-term contracts: a contract spanning many decades may contemplate that over such a period one of the party's interests, personnel or resources may change so much that there will come a time when that party strongly desires to get out of the

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<sup>70</sup> This does not always hold true – for example, a cable company who wanted to get into the wireless telephone business would probably not go to each cell phone subscriber to set up a contract as a cell phone provider. It is much cheaper to go to an existing cell phone provider and buy its contracts.

contract because it is worth so little. In such a case, assignments will be more valuable to the assigning party, and thus more likely to outweigh the harms to the non-assigning party.

#### **D. Symmetry Between Rights and Obligations**

A final introductory note is that the assignment of contract rights is very similar to the assignment (“delegation”) of performance. As a theoretical matter, the model is the same: a promisor worries about harm because caused by the promisee’s assignment, where the harm is the increased cost of having to perform to the new person (rather than the decreased value of performance received from an inferior promisor-assignee). The promisee seeks to find someone who values the contract rights more than he does to gain a benefit from assignment (rather than a promisor trying to find someone who “values” the obligation more in that they can perform at lower cost).

Descriptively, the line between assigning contract rights and assigning contract obligations is fuzzy. For example, many of the concerns that promisors have about assigning rights can be understood in terms of unspecified promises by the initial promisee as to how she will behave in connection with those rights. Thus a lessee’s transfer of a lease involves a transfer of the possessory right, but a lessor is concerned with how the lessee takes care of the property and how much noise that person makes, and thus can be said to be concerned about unspecified performance obligations as well. Similarly, other considerations that this Article describes — price discrimination and the administrative cost of assignment — apply equally well to the assignment of rights as they do to the assignment of obligations.

Therefore, as the rest of this Article, which presents in more detail the various reasons for restricting assignment and examples illustrating those reasons, does not make any effort to distinguish analytically situations where rights are being assigned from those where obligations are being assigned.

### **III. Cost or Value of Performance**

This Part discusses the considerations that will lead parties to restrict assignment because an assignment is likely to cause substantial harm to the non-assigning party in the form of an increased cost of performance to a new promisee (if the non-assigning party is a promisor) or a decreased value of performance from a new promisor (if the non-assigning party is a promisee).

### **A. Incomplete Inability to Contract for Optimal Obligations**

First, limitations on assignability are likely to be optimal when it is too costly for the parties to specify adequately the performance that is desired of a promisor.<sup>71</sup> In some contractual relationships, it is impossible (very costly) to specify all the dimensions of the desired obligations in the optimal bargain between the parties. This could arise several related ways. First, it may be that specification is simply difficult. The Yo Yo Ma contract is an example of this: it is very difficult to specify precisely how to play a cello piece with great skill. Second, specification may be too “costly” in that the optimal bargain involves the promisor having flexibility in the future. For example, it may be valuable for a distributor (hired by a manufacturer) to have the ability to respond to market conditions post-contracting. Finally, it may be impossible to have the perfect bargain, even if written, effectively monitored and enforced in court.

This lack of specificity creates a range of performances that will not be contract breaches, which have different values to a promisee.<sup>72</sup> Should the promisee desire and pay more for the services of a more skilled promisor, a substitute performance by a less skilled promisor would inflict harm on the promisee. Because the difference between the two performances could not be specified in the contract, this harm is not compensable by damages, even if the original promisor remains liable for breach. The result is that, in order to prevent this harm to the non-assigning promisor from being inflicted for a smaller gain to the promisor, it may be mutually beneficial to prohibit the promisor from assigning his obligations, guaranteeing the promisee a sufficiently valuable performance within the contractually permissible range. Prohibitions on assignment of rights work the same because a promisee’s use rights can constitute a performance which affects the promisor. Where a promisor (such as an insurance company) expects certain implicit “performance” from a promisor (such as non-risky behavior from a health insurance policyholder), it may harm the promisor if the promisee assigns her rights, and so it may be mutually beneficial to prohibit that assignment.

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<sup>71</sup> Or the implicit “performance” desired of a promisee, such as how a tenant makes use of her possessory right or how risky the activities of a health insurance policyholder are.

<sup>72</sup> Cf. Dimatteo, *supra* note 6, at 437–38 (describing a discretion-versus-specificity dichotomy, and concluding that “the greater the specificity within the contract on how duties are to be performed, the easier it is for a court to allow assignment”).

This category can be split into three different but overlapping contexts where unspecified desired performance can lead to a substantial harm caused by assignment to the non-assigning party. The first is where that party has investigated potential contracting partners and has chosen one, expecting that that particular person or entity will deliver a performance within the contractual range that is particularly valuable. The second is where the non-assigning party did not infer at the time of contracting that this particular partner would deliver the desired performance where others would not — but rather where the fact that non-assignability forces the counterparty to remain the same will result in the desired performance (e.g., by acquiring expertise).<sup>73</sup> The third is where part of the desired “performance” is the conduct of third parties not parties to the contract. A party may choose a partner because her identity and reputation will lead to desired conduct from third parties, rather than as a guarantee that the counterparty herself will engage in desired conduct.

### **1. Identity as Guarantee of Desired Performance**

One way for a party to assure himself of getting the desired but unspecifiable high-value performance out of the other party is to use the identity or characteristics of that counterparty as a low-cost proxy for specifying performance.<sup>74</sup> Thus in the process of contracting, a future promisee investigates potential promisors (or vice versa) and selects one — on the basis of interviews; reputation for good performance; past experience; educational, financial, or other credentials — that he expects will perform the desired service in the way he wants. Because the optimal bargain is too costly to contract for or enforce, the promisee uses the promisor’s characteristics or identity as a trademark: drawing the conclusion from those qualities that the promisor will perform well.

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<sup>73</sup> The first two may be combined in any particular contractual context: An employer, for instance, may choose an employee that it thinks will learn the fastest and interact with clients best, based upon a resume and interview, and fear that an assignment would be to someone who lacks the credentials. But an employer may also hope that the new hire will stay for many years and become valuable by gaining expertise; an assignment would cause harm by eliminating the expertise.

<sup>74</sup> The court in *Corell v. Teamsters Local Union No. 828*, No. 00-1098, 2002 WL 31018534 (Iowa Ct. App. Sept. 11, 2002), recognized the value of a particular promisor’s expected performance within range of contractually “legal” performances when it noted that a nonassignable personal services contract “is a contract in which the offeree is vested with discretion in accomplishing the assigned tasks because his skills, knowledge, experience and expertise are unique to the area and could not be duplicated by others.” *Id.* at \*2.

Assignment may inflict harm on a non-assigning party because the assignee has not been “vetted”: if performance has to be done by someone who lacks the reputation or other characteristics of the initially chosen party, it may reduce the likelihood that the assignee will deliver the desired performance. The inability to specify or enforce the optimal bargain between the original parties leaves the non-assigning party with no choice but to accept the less valuable performance.

What follows is a description of different contracts that demonstrates how restrictions on assignment derive from the use of identity as a proxy for receiving desired performance.<sup>75</sup> This demonstration is followed by several counterexamples that show how contracts are made assignable when the principles of desired yet unspecified performance do not apply.

### **a) Employment Contracts**

One would expect most employment contracts not to be assignable.

As to assignment by the employee, an employer often makes a judgment based on a large number of factors — interviews, prior experience, education — that the employee will not only complete the requirements of her job description but complete them in a satisfactory way, and also be a good fit in the firm.<sup>76</sup> To the extent that strong job performance and good fit within a firm is difficult to specify, and if employers invest substantial resources in selecting employees, then employers are likely to believe that those that they have chosen will provide a performance within the contractually permissible range that is more valuable than other potential employees would provide. Thus, we should expect few employment contracts to permit assignment by the employee. Examples of employment contracts include an employment agreement between an insurance agency and one of its agents,<sup>77</sup> an employment agreement between a national

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<sup>75</sup> Many of the examples that follow involve economic analyses that are similar to one another. After getting an idea of how the analysis works with a few of them, some readers may want to proceed to section III.A.2, *infra*.

<sup>76</sup> Because an employment relationship more ongoing than an independent contractor relationship (e.g., with a plumber), the not-very-specifiable element of having a good interpersonal relationship with other workers is an important element of that employee’s performance.

<sup>77</sup> *See, e.g.,* Campbell v. Millennium Ventures, LLC, 55 P.3d 429 (N.M. App. 2002) (“Agreement shall inure to the benefit of and shall be binding upon the parties, their successors, assigns, or personal representatives; however, the Employee may not transfer or assign Employee’s obligations under this Agreement.”); Weldon v. Great White N. Distribution Svcs., L.L.C., 197 F. Supp. 2d 893, 897, 900 n.4 (describing an employment agreement between a company and its sales representative that did not permit

accounting firm and one of its employees,<sup>78</sup> and others.<sup>79</sup> Moreover, even if an employment agreement does not so explicitly state, an assignment of the employee's end of a contract will almost certainly be non-assignable by default.<sup>80</sup>

As to assignability on the employer's end, an employee contracts with a firm not only to get paid, but also for a host of intangible elements of performance that the employer provides — intellectually interesting work, favorable opportunities for promotion, training, amiable colleagues,<sup>81</sup> good practices regarding work hours or leave, and a good location for a commute. Many of these features will be learned about by the employee through means like firm reputation, interviews, and interaction with other employees. Importantly, many of them (such as intellectual challenge or a collegial atmosphere) will be very costly to articulate in a contract and enforce. And also importantly, it may not be desirable for the parties to tie the employer's hand in some of these matters. For example, writing good work-hours policy into stone may result in business inflexibility and inability to minimize costs in a recession; and requiring that it stay in its physical location may foreclose a favorable office real estate deal.

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the employee's "rights and obligations under th[e] Agreement [to be] assigned, transferred, or otherwise disposed of . . . without the other party's written consent").

<sup>78</sup> See *McGladrey & Pullen LP v. Shrader*, 62 Va. Cir. 401 (Va. Cir. Ct. 2003) ("ASSIGNMENT: Employee acknowledges that services to be rendered by him or her are unique and personal. Accordingly, Employee may not assign any of his or her rights or delegate any of his or her duties or obligations under the Agreement.").

<sup>79</sup> See, e.g., *O'Donnell v. Arrow Electronics, Inc.*, 742 N.Y.S.2d 579, 581 (App. Div. 2002) ("The subject employment agreement . . . explicitly provided that it could not be assigned without the consent of the parties to the agreement."); Patricia Lofton Hardaway, *Employment Agreements*, in *DRAFTING CORPORATE AGREEMENTS 2001: CONVERTING THE DEAL INTO AN EFFECTIVE CONTRACT*, 257, 300 (PLI Corp. L. & Practice Course, Handbook Series No. B0-016M, 2001), available in WL 1268 PLI/Corp 257 (providing a sample employment agreement for executives that provides: "By reason of the special and unique nature of the services hereunder, it is agreed that neither party hereto may assign any interest, rights or duties which it or he may have in this Agreement without the prior written consent of the other party," except that in a merger or acquisition the successor company would inherit the contract).

<sup>80</sup> See *Equifax Svcs., Inc. v. Hitz*, 905 F.2d 1355, 1361 (10th Cir. 1990) ("[A]n employee's duty to perform under an employment contract generally is not delegable."); *Kathadin Ins. Group v. Elwell*, No. Civ.A.CV-00-198, 2001 WL 1736572, at \*4 & n.2 (Me. Super. July 9, 2001) (same).

<sup>81</sup> Cf. *Dimatteo*, *supra* note 6, at 432 ("The presence of key personnel may have been an implied part of the basis of the bargain.").

Thus, because contracts will not ensure that the assignee of the employer's side of an employment contract will provide the same intangible performance, and because an employee are likely to select an employer whose intangible performance is relatively valuable to her, an assignment will often inflict a significant harm on the employee. So one would expect many employment contracts not to permit assignment by the employer. This is in fact the case: employment contracts often explicitly forbid assignment.<sup>82</sup> Many employment contracts are silent on the issue and probably operate under a default rule that the employer's side of the agreement is not assignable because the employment agreement is a "personal services contract."<sup>83</sup>

However, partial restrictions on assignments by employers will also often make sense. Certain assignments are not likely to harm an employee because the performance that she expects from her carefully chosen employer will not change after the transaction. For example, assigning an employment agreement among affiliated corporations shouldn't much harm an employee: such assignments may be entirely formalistic and not affect the employee's work experience at all. Many of the unwritten elements of performance are likely to be provided by an affiliate as well as the original entity — the kind of work the business does, the identity of coworkers and managers, its financial stability and thus promise of future opportunity and continued employment, and its various policies. Thus one would expect some employment

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<sup>82</sup> See, e.g., O'Donnell, 742 N.Y.S.2d at 581 ("The subject employment agreement . . . explicitly provided that it could not be assigned without the consent of the parties to the agreement.").

<sup>83</sup> See, e.g., Logical Networks, Inc. v. Murdock, No. 239779, 2002 WL 31187877, at \*2 (Mich. App. Oct. 1, 2002) (declaring, in a case involving a sales representative and later manager for a technology distribution company, that "the law is clear that an employee cannot be compelled to work for another employer."). For example, in *Roeder v. Ferrell-Duncan Clinic, Inc.*, No. 103CC0497, 2003 WL 21976388 (Mo. Cir. Ct., Aug. 11, 2003), a clinic "provide[d] professional services through employment of qualified and duly licensed physicians," *id.* at \*1, and entered an employment contract with those physicians whose only mention of assignment was the clinic's ability to assign its obligation to collect fees for the doctors' services, *id.* at \*2. The court held that, apart from this, the remainder of the agreement was not assignable by the clinic: "Personal services contracts are not assignable . . . when the personal services constitute the main component of the agreement . . . . Because plaintiff[']s . . . personal services constitute a main component of his Contract with Ferrell-Duncan, his consent must be obtained before it can be assigned by Ferrell-Duncan." *Id.* at \*4.

contracts to provide for assignments to affiliates or related entities,<sup>84</sup> at least when those entities are engaged in the same or closely related businesses.<sup>85</sup>

A related example is the assignment of an employment agreement to a purchaser of the original employer. The harm caused by the failure to fully specify desired performance is mitigated by the fact that when an entire business is transferred, the transferee new employer has many of the same attributes of the initial employer. Thus many of the unwritten elements of performance are likely to be the same such as coworkers and kind of work. Moreover, these assignments are often those where the *value to the assigning employer* of assignment is high — it minimizes the ability of employees to become holdouts and frustrate an efficient business transaction.<sup>86</sup> So, because permitting assignments with sales of businesses should cause relatively little harm to the employee and should be valuable to the employer, we should expect that some employment agreements permit assignment by the employer to successors.<sup>87</sup> One

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<sup>84</sup> See, e.g., *Cinicola v. Scharffenberger*, 248 F.3d 110, 117 n.5 (3d Cir. 2001) (describing an employment agreement between physicians and a university within a health care system, that could “be assigned by [the University] or [an affiliated health group] to any parent, subsidiary, or affiliated corporation without prior approval of [the] Physician.” (third alteration in original)).

<sup>85</sup> See, e.g., *id.* (within a healthcare system). One might conceive of many professional sports teams’ ability to assign the employment agreement of many of their players to other teams within the same league as similar to this affiliate point. See, e.g., *Pro Football Inc. v. Paul*, 569 S.E.2d 66, 68 (Va. App. 2002) (“Unless this contract specifically provides otherwise, [the Broncos] may assign this contract and Player’s services under this contract to any successor to [the Broncos] franchise or to any other Club in the League.” (alterations in original)). Although the different teams within, say, the NFL, will offer different experiences to their players, such as home stadium location, chances of winning a championship. Because these leagues are relatively uniform in many of their practices, and because the most important thing to many players will be the ability to get playing time (which seems likely to get no worse on a team to which a player is traded), much of the unwritten performance will be the same, suggesting that the harm from assignment will be small for most players. However, for marquee players, whose exposure and playing time is secure, there may be significant value in the unwritten performance elements such as treatment as a star, closeness to home. Thus it is sensible that many of these players must consent before their contracts are transferred to another team. See, e.g., Ross Newhan & Jason Reid, *Blockbuster Remains on Critical List*, L.A. TIMES, Dec. 19, 2003, at D1 (noting that superstar shortstop Alex Rodriguez had a “no-trade” clause in his contract with the Texas Rangers, meaning that the “[p]layer may not be traded without his permission”).

<sup>86</sup> See *supra* TAN 62.

<sup>87</sup> See, e.g., *Weldon v. Great White Distribution Svcs., L.L.C.*, 197 F. Supp. 2d 893 (E.D. Mich. 2002) (describing a contract between a mailing services company and one of its sales representatives, which provided: “Neither this agreement, nor any of the parties’ rights and obligations under this Agreement

court has suggested that there should be an exception to the default rule of nonassignability of certain employment contracts in cases where an entire business is transferred.<sup>88</sup>

### **b) Contracts for Creative Content**

Contracts between artists and those who hire them — the paradigm example of “personal service contracts”<sup>89</sup> — have major components of unspecifiable performance. When someone hires an author to write a book, for example, the details of performance cannot be specified because it would cost too much to negotiate and write contents of the book into the contract. And specifying detailed contours up front is costly in that it stifles the benefit of hiring an artist — to allow expression of creativity as a work develops.

Thus, flexible standards are built into such contracts: an author in an author-publisher contract is typically required to deliver a “satisfactory manuscript,”<sup>90</sup> which in some instances is further defined loosely based on an author’s prior work quality,<sup>91</sup> but which may also be left undefined,<sup>92</sup> and which incorporates a requirement of good faith imposed by courts.<sup>93</sup> The fact

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may be assigned . . . without the other party’s written consent, *unless such assignment is a transfer or disposition to a successor to the business or to the purchaser in a sale of Great White North*, in which case consent of the Employee . . . is not required.”); *Creative Telecomms., Inc. v. Breeden*, 120 F. Supp. 2d 1225, 1228 n.1 (describing an employment agreement between a computer networking company and its President and Vice President that provided that it was “assignable in connection with the sale of all of ComputerTime assets.”); *Dixon v. Pro Image Inc.*, 987 P.2d 48 (Utah 1999) (describing an agreement providing that “[Pro Image] may assign its rights under this Agreement . . . to any Buyer in a Sale”).

<sup>88</sup> *See, e.g., Roeder v. Ferrell-Duncan Clinic, Inc.*, No. 103CC0497, 2003 WL 21976388, \*4 n.1 (Mo. Cir. Ct. Aug. 11, 2003) (“Therefore, another exception to the general rule against assignability of professional service contracts is when an employment contract is assigned in conjunction with the sale of a business and assets; such an assignment is deemed incident to the property conveyed.”).

<sup>89</sup> *See, e.g., In re Fastrax, Inc.*, 129 B.R. 274, 278 (Bankr. M.D. Fla. 1991) (“Typical personal service contracts include a contract to paint a picture, and a contract between an author and his publisher.”).

<sup>90</sup> Martin P. Levin, *A New Guide to Negotiating the Author-Publisher Contract*, 6 CARDOZO ARTS & ENT. L.J. 411, 428 (1988). Formally, the submission of an acceptable manuscript is in part a condition of receiving the future benefits of the

<sup>91</sup> *See, e.g., Helprin v. Harcourt, Inc.*, 277 F. Supp. 2d 327, 332 (S.D.N.Y. 2003) (“A Work shall be ‘acceptable’ under this Agreement if such Work meets a standard comparable to the literary merit of [Helprin’s] previous works.” (alteration in original)).

<sup>92</sup> *See, e.g., Brabec v. Delma Thomson Learning*, No. 00-C-137-C, 2000 WL 34233872, \*1 (W.D. Wis. Dec. 20, 2000) (“The contract required plaintiff to submit a ‘final draft’ of a complete and acceptable manuscript to defendant on October 1, 1993. . . . The contract specified that defendant was entitled ‘in its sole judgment [to] determine whether the manuscript is acceptable and ready for publication.’”).

that the required product is ill defined and the fact that publishers do not have *carte blanche* in rejecting authors' work means that contractually acceptable performance includes a range of outputs of different quality. The publisher has particular expectations of the author's performance within that range — which is reflected in the advance paid and amount of investment in advertising — that could be disappointed were another author substituted. This would cause harm to the publisher, and the parties should have the contract be non-assignable to prevent this harm.

Note that “unspecifiable performance” runs in the other direction as well: First, the parties would optimally try to create a perfect formula for when the publisher would accept a manuscript and when not,<sup>94</sup> but this is too costly to specify. Thus the publisher is left with discretion to act, in exercising its judgment of satisfaction, within a considerable range. The author has certain expectations of how this judgment will be exercised by the particular publisher she is working with, and it could harm the author to find herself dealing with the stricter or more mercurial standards of a substitute publisher.<sup>95</sup> Second, publishers provide performance that is not readily specified in the form of editing manuscripts, the quality of which is not only difficult to specify but the intensity of which may be expressly left unspecified by author-publisher contracts.<sup>96</sup> Thus, publishers have a contractually acceptable range of performance that they can deliver in the quality and quantity of editing and an author could be harmed by an assignment of this responsibility from a publisher that provides better or more editing to one that provides worse editing.

Thus, we should expect author-publisher and similar contracts not to be assignable.<sup>97</sup> One commentator notes that “[t]he publisher normally reserves the right to assign without the

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<sup>93</sup> See Levin, *supra* note 90, at 429–30.

<sup>94</sup> Such a perfect formula would give the author optimal incentives to produce the best work possible.

<sup>95</sup> See FARNSWORTH, *supra* note 6, § 11.4, at 715 (“If . . . the obligor’s duty depends on the personal discretion of the other party . . . , substitution of the assignee for the assignor may result in a material change in the obligor’s duty.”).

<sup>96</sup> See *Helprin*, 277 F. Supp. 2d at 332–33 (“[Harcourt] recognizes its obligation to give editorial assistance to [Helprin] in order to assist [him] in making the manuscript . . . acceptable for publication by [Harcourt]. However, [Harcourt] reserves the right to determine the amount and usefulness of its editorial assistance . . . .” (alterations in original)).

<sup>97</sup> See Levin, *supra* note 90, at 440–41.

author's consent if there is a transfer of all or substantially all of the publisher's assets."<sup>98</sup> This exception to non-assignability is justified both from the perspective of minimizing harm to the non-assigning author — since the editorial and decisionmaking staff is likely to stay the same in a sale of the business and the performance within the contractually permissible range is unlikely to change — and the perspective of maximizing the value to the assigning publisher because it prevents holdout problems.

### c) Vertical Business Relationships

There are various contracts embodying vertical relationships between business entities, of varying degrees of integration. At one end of the spectrum lie franchises, where the franchisee operates under the franchise's brand, and where the franchisee's business arises entirely from its relationship with the franchisor. At the other end are more standard supply relationships — where one business has contracted with another to provide one of its inputs but does not hold itself out as a distributor of its supplier's brands. In between there are things like distribution agreements where a retailer sells several brands of products, including the supplier's.

*Franchising Relationships.* — Many franchise agreements are structured so that the franchisee receives most of its inputs from the franchisor or its designee, and operate under the franchise's trademarks. Many franchisors receive a percentage of their franchisees' revenues,<sup>99</sup> or similarly earn money from supplying the franchisees with the ultimate product or materials.<sup>100</sup>

The goal of the franchisor in the relationship is to have the franchisees succeed so that the revenue royalties or materials-supply revenue is maximized. It is difficult to specify what actual

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<sup>98</sup> *Id.* at 441.

<sup>99</sup> *See, e.g.*, World Franchising Directory, Bond's Top 100: Dunkin' Donuts, <http://www.worldfranchising.com/Top100/Food/DunkinDonuts.htm> (last visited July 18, 2004) ("Dunkin' Donuts franchisees pay continuing franchise fees equaling 5 to 5.9% and advertising fees equaling 5% of gross revenue"); World Franchising Directory, Bond's Top 100: 7-Eleven, <http://www.worldfranchising.com/Top100/Retail/7Eleven.htm> (last visited July 18, 2004) ("7-11 franchisees pay on-going fees equaling 52% of gross revenues."); World Franchising Directory, Bond's Top 100: General Nutrition Centers, <http://www.worldfranchising.com/Top100/Retail/GNC.htm> (last visited July 18, 2004) ("GNC franchisees pay royalties equaling 6% of gross revenue.").

<sup>100</sup> *See, e.g.*, *Chevron U.S.A., Inc. v. Cayetano*, 198 F. Supp. 2d 1182, 1185 (D. Haw. 2002) (describing the Chevron gasoline dealer-lessee agreement, and noting that Chevron makes earnings by a combination of monthly lease rent plus sale of gasoline supplied to the dealers).

conduct is required, and it is certain that success in the franchising business requires the franchisee's flexibility to respond to market conditions (making specification costly in the "it precludes optimal responses to changing conditions" sense). Therefore franchisors will rely on a number of facts about a franchisee — financial condition, training, business experience, prior success as a franchisee<sup>101</sup> — to determine that the performance will be good and that the franchise will exercise the granted flexibility in a skilled manner. Franchisors may care more than other suppliers that franchisees deliver "successful" performance — and an assignment to a new franchisee who would not deliver the unspecified yet desired performance would cause particularly large harm to the franchisor — because every franchisee operates under the franchise brand and the goodwill of the entire franchise depends on how the brand is presented to customers by every franchisee.<sup>102</sup>

For this reason, one would expect that franchisees' ends of franchise agreements would not be freely assignable, and most are not.<sup>103</sup>

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<sup>101</sup> See Franchise Direct, Friendly's Franchise Opportunity, <http://www.franchisedirect.com/directory/friendlys.htm> (last visited July 18, 2004) (providing minimum liquid capital and net worth requirements for franchisees).

<sup>102</sup> See KAPLOW & AREEDA, *ANTITRUST ANALYSIS*, § \_\_, at \_\_ (5th ed. 1997). Franchises place high value on presenting a uniform product and uniform quality to their customers. See, e.g., *Burger King Corporation v. Hinton, Inc.*, 203 F. Supp. 2d 1357, 1363 (S.D. Fla. 2002) (describing Burger King franchise agreements, which state that "BKC has established a high reputation and positive image . . . as to the quality of products and services available at Burger King Restaurants, which reputation and image [are] unique benefits to BKC and its Franchisee" and specify uniform standards of operation to maintain that image); *Tserpelis v. Mister Softee, Inc.*, 106 F. Supp. 2d 423, 424 (E.D.N.Y. 1999) (describing the Mister Softee franchise agreement, which states: "In view of the fact that the consumer brand name 'Mister Softee' and the 'Mister Softee' ice cream truck franchises have been made valuable through the efforts of hundreds of . . . Dealers in conforming to uniform plans, procedures, and policies . . . Dealer agrees to maintain and operate his 'Mister Softee' truck(s) in strict conformance with the plans, procedures and policies . . . prescribed by Mister Softee, Inc. and Distributor.").

<sup>103</sup> See, e.g., *Midwest Automotive III, LLC v. Iowa Dep't of Transp.*, 646 N.W.2d 417, 420 (Iowa 2002) (describing a Jaguar dealership franchise that was "not transferable to another dealer without Jaguar's permission"); *Mister Softee*, 106 F. Supp. 2d at 424 (Mr. Softee franchise agreement "not assignable by Dealer except upon the following terms: (a) Dealer shall first obtain the written consent of Distributor and Mister Softee, Inc."); *Perez v. McDonald's Corp.*, 60 F. Supp. 2d 1030, 1032–33 (E.D. Cal. 1998) (Franchise Agreement with McDonald's stating that "Licensee shall not sell, transfer or assign this License to any person or persons without Licensor's prior written consent. Such consent shall not be arbitrarily withheld," and providing a list of eight factors that McDonald's shall consider in approving a

It should be noted, however, that while most franchise agreements prohibit the franchisee from assigning without the franchisor's consent, many also provide that this consent cannot be unreasonably withheld,<sup>104</sup> and some explicitly provide factors to be considered.<sup>105</sup> This makes sense in the franchise context.

Because of the long-term nature of the franchise relationship and because of the substantial investment usually made by a franchisee, the franchisee will likely want to transfer its business at some point. The desired transfer could arise from the franchisee's retirement, incapacity, or death, or from the understandable desire to "cash out" by selling the business the franchisee worked so hard to build.<sup>106</sup>

The long term nature of the contract makes it likely that at some point, the franchisee's valuation of the contract will sharply decline. Assignment at such a time becomes very valuable to the assigning franchisee — since the assignee's valuation will probably not have similarly plummeted, the premium that the assignee receives from selling the contract at that time is substantial. The franchisor's ability to withhold consent within reason or according to some objective factors will, moreover, limit its harm. Thus, it is likely that the benefit of some

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potential assignee); *Adams v. G.J. Creel & Sons, Inc.*, 465 S.E.2d 84 (S.C. 1995) ("Helen Adams . . . entered into a franchise agreement with Gulf Oil Corporation . . . to purchase petroleum products for resale at her service station. The agreement specifically stated that the franchise contract was not assignable by Adams without the written consent of Gulf."); *Richter v. Dairy Queen of S. Ariz., Inc.*, 643 P.2d 508 (Ariz. App. 1982) ("Licensee agrees that the interest of Licensee hereunder may not be transferred, assigned or alienated in whole or in part without the written consent of Company (Dairy Queen of Southern Arizona), which consent shall not be withheld unreasonably . . ."); *McDaniel v. General Motors Corp.*, 480 F. Supp. 666, 670 (E.D.N.Y. 1979) (describing a Franchise Agreement between Oldsmobile and a multi-brand car dealer that sold Oldsmobiles that stated "Dealer shall not transfer or assign or attempt to transfer or assign any other right or transfer or delegate any obligation or responsibility of Dealer under this Agreement unless it shall have been approved in writing by Oldsmobile").

<sup>104</sup> See sources cited *supra* note 103.

<sup>105</sup> See, e.g., *Perez*, 60 F. Supp. 2d at 1033. These limitations on franchisors' ability to withhold consent are real, moreover, as courts have held some denials of consent to be unreasonable. See *Richter*, 643 P.2d at 510.

<sup>106</sup> JEFFREY A. SCHNEIDER & ROBERT J. NYE, *BUSINESS FRANCHISE LAW* 152–53 (2003). Schneider and Nye go on to note that the significant value to a franchisee of the right to transfer leads some states to restrict the right to disapprove of a transfer. See *id.* at 153.

assignability to a franchisee will outweigh the cost to a franchisor, and that therefore their contract will permit some assignment.

The franchisor's end of the contract should also often be non-assignable. A franchisee's success is dependent upon the conduct of the franchisor such as the quality of brand advertising, the quality of supplies provided, in a perhaps unwritten understanding that the relationship will continue (be renewed) on terms that are sufficiently favorable to the franchisee at the end of each contract period. Much of this behavior is impossible to specify, and the franchisee must rely on the good reputation and soundness of the franchisor to ensure the desired performance.<sup>107</sup> Many franchisors therefore do not have the right to freely assign their interests in franchise contracts.<sup>108</sup>

Yet the need for non-assignability is somewhat weaker on the franchisor side because there may be a smaller amount of unspecifiable conduct. For example, much of the value of being a gasoline or food franchisee may simply come from (1) having a license to use the franchise's trademarks, and (2) a reliable supply (of gasoline or food, both of which are relatively standardized products). Because these are rather well-specified obligations, it is not surprising to see some franchise agreements with less restrictive assignment provisions for the franchisor.<sup>109</sup> Harm to the franchisee may be kept particularly low, and thus assignments are

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<sup>107</sup> In *Koragny v. Mobil Oil Corp.*, 84 F. Supp. 2d 660, 665 (D. Md. 2000), for example, a franchisee argued that he sought the assurance that Mobil could not assign the contract in order to "guarantee that he was dealing with a respected company, such as Mobil."

<sup>108</sup> See, e.g., *Crim Truck & Tractor Co. v. Navistar Intern. Transp. Corp.*, 823 S.W.2d 591 (Tex. 1992) ("This is a personal agreement, involving mutual confidence and trust, and it may not be assigned by either party without the written consent of the other party, except that [Navistar] may, however, assign the agreement to any of its subsidiary or affiliated corporations, without the consent of [Crim]."); *Koragny v. Mobil Oil Corp.*, 84 F. Supp. 2d at 662, 665 (describing a franchise agreement between Mobil and a dealer that explicitly provided that Mobil could assign the franchise agreement to affiliated corporations; that was silent as to other kinds of assignments; and that the dealer claimed he had intended to mean forbade other assignments because of his desire to remain affiliated with a reputable company such as Mobil).

<sup>109</sup> See, e.g., *Clark v. BP Oil Co.*, 930 F. Supp. 1196 (E.D. Tenn. 1996) (describing a gasoline franchise/dealer agreement that clearly prohibited assignment by the dealer, but was silent on assignability by the franchisor BP; and holding that the contract was assignable by BP because its obligations — furnishing the dealer's station lease, licensing the BP trademark, and supplying fuel — could be performed as well by an assignee as by BP); *Richardson v. BP Oil Co.*, 477 S.E.2d 686 (describing the assignment by BP of numerous franchise agreements, upon which BP gave notice to franchisees but did not seek their consent).

likely to be allowed, if they are to entities (even those not formally affiliated) within the franchisor's system, such as mid-level distributors; in such instances, many of the business practices of the franchisor thought desirable by the franchisee may be shared by potential assignees.<sup>110</sup>

*Distributorship Agreement and Supply Agreements* — Not too far distant from franchises are what I call distributorships, where a distributor is hired by a manufacturer to market and sell the manufacturer's product. The distributor markets the manufacturer's product under the manufacturer's brand. Distributors can be single-brand (closer to franchisees) or multiple-brand sellers. Examples range from agreements between wineries and distributors who sell wines to liquor retailers, to agreements between independent insurance agents and the insurers that they provide,<sup>111</sup> to an appliance retailer selling several brands of refrigerator.

For many of the same reasons of unspecifiable performance, it is probably not optimal for either side of distributorship agreements to be assignable. First, from the perspective of manufacturer or trademark holder, the goal in selecting a distributor is the same as the goal in selecting a franchisee: in choosing a distributor, one who will be successful in understanding, marketing, and selling the product, and who will ensure that the brand is not tarnished. Again, little of this successful behavior can be codified *ex ante* in contract, and the manufacturer must conclude that the performance of the distributor will be acceptable from such factors such as technical and business experience, financial sophistication, licensing and disciplinary record. Because this performance is not specifiable, an assignment to an unvetted distributor will lose the manufacturer the benefit of finding one who will provide the desired performance.<sup>112</sup> Thus, the harm from assignment by the distributor is likely to be high, and distributors are unlikely to

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<sup>110</sup> See, e.g., *Beachler v. Amoco Oil Co.*, 112 F.3d 902, 907 (7th Cir. 1997) (describing a franchise agreement between Amoco and a dealer that, while silent on assignments by Amoco generally, clearly contemplated assignments by Amoco to one of its jobbers: "If this Agreement is assigned by Amoco to an Amoco jobber, the prices to be paid by [the] Dealer for motor fuel and other products hereunder shall be as established by said jobber.").

<sup>111</sup> See sources cited *infra* note 113.

<sup>112</sup> While the harm caused by an unsuccessful distributor can be mitigated by the installation of a new competing distributor, such installation will force the manufacturer to incur potentially substantial start-up costs.

be permitted to assign their side of the agreement.<sup>113</sup> In the case of exclusive distributorships — where the manufacturer sells its product through only one distributor — the manufacturer’s revenues depend directly on the successful performance of the distributor, meaning the incentive to prevent an assignment from jeopardizing the desired but unspecified performance is particularly strong.<sup>114</sup>

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<sup>113</sup> See, e.g., *E & J Winery v. Morand Bros. Beverage Co.*, 247 F. Supp. 2d 973, 974–75 (N.D. Ill. 2002) (describing an agreement between a winery and liquor-distributor companies for the distributors to “sell, distribute, promote, and merchandise” the winery’s products, which agreements specified that “[n]either Distributor nor Winery may sell, assign, or transfer its rights under this agreement” (alteration in original)); *The Courage Co., L.L.C. v. The Chemshare Corp.*, 93 S.W.3d 323, 327–328 (Tex. App. 2002) (describing an agreement under which a software maker hired distributor to market its software, in return for a royalty payments on the distributor’s sales; the agreement “was not assignable without the prior written consent of [the software maker]”).

Independent agents selling insurance on behalf of insurance companies — who, in their application to the insurance company may be asked to specify previous bankruptcies, disciplinary or criminal actions, and agree to a background check — often are unable to assign their end of their producer agreements. For an example, see *Fidelity & Guaranty Life Ins. Co., General Producer’s Agreement* (Jan. 2002), available at <http://www.americanfinancialpartners.net/contracts/FnGContract.pdf>, which authorizes the general producer “and [its] Producers to solicit the sale of contracts of life insurance and annuities which the Company [provides] and which are described in the attached . . . Schedule.” *Id.* § 3.B. The contract restricts assignment by the insurance agent: “You shall not assign, transfer, or pledge this Agreement or any commission hereunder without the written consent of the Company which shall not be unreasonably withheld.” *Id.* § 18.A. See also *AIG Annuity Ins. Co. & Am. Gen. Life Ins. Co., Agency Agreement* ¶ VII.E (“Neither the agreement, any duties or delegation under this agreement . . . , nor any interest herein, nor any right or claim created hereby . . . , shall be assignable, except upon the written consent of the Insurer.”), available at <http://www.emimktg.com/AIG-Producer-contract-a.pdf> (last visited March 19, 2004).

<sup>114</sup> In *Quality Healthcare Equipment, Inc., v. Lumex, Inc.*, No. 96 C 4847, 1996 WL 604059 (N.D. Ill. 1996), Quality was a 5-year exclusive distributor in a geographical region for “air loss therapy bed systems,” under which Quality was required to lease or purchase a minimum commitment of product units. *Id.* at \*1. The contract provided that “Neither party to this Agreement may assign its obligations hereunder without the prior written consent of the other, which consent shall not be unreasonably withheld.” *Id.* at \*1.

In *Hannex Corp. v. GMI, Inc.*, 140 F.3d 194, (2d Cir. 1998), a Japanese manufacturer of underwater cameras entered a semi-exclusive distributorship agreement with an American distributor. The agreement “was assignable by either party with the consent of the other, which consent could not be unreasonably withheld.” *Id.* at 197.

In *Emerson Radio Corp. v. Orion Sales, Inc.*, 253 F.3d 159 (3d Cir. 2001), Emerson, a brand-management company that licensed its trademark to electronic equipment producers but did not make

On the other side, the distributor's interest in consistent identity of a manufacturer depends on several circumstances. A single-brand distributor is much like a franchisor, depending on the quality of the products, the strength of the brand, and advertising. These features are not well specifiable, and since the substitute performance may not perform as well as the original, assignment is likely to be limited.<sup>115</sup>

A multibrand distributor is likely to be less dependent upon these features of any one particular manufacturer: the ability to easily substitute brands may provide some protection against the possibility of finding oneself associated with a poor performer. It is possible that where the goods and services are less standardized the distributor may be particularly concerned about the continuing quality of a chosen manufacturer and thus be less willing to suffer assignment,<sup>116</sup> whereas distributors of less brand-differentiated products of more standardized quality may be less concerned about the ability to find an adequate replacement and thus permit assignment.<sup>117</sup>

Supply agreements are less branded: an upstream supplier agrees to sell goods or services to a purchase who packages them into a new product. The supplier may have fewer unspecifiable performance demands on the buyer: the buyer does not act in the supplier's name, so goodwill is not a concern. Moreover, a supply contract probably specifies a price at which sales will be made, so the supplier has less of an equity-like stake in the buyer than a franchisor has in a franchisee. In most cases, this will make the long-term success of any individual buyer less important to a seller. More of the value to the parties is in the specified conduct — an

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equipment itself, entered into a licensing/distribution agreement whereby Orion would have the exclusive right to produce Emerson equipment for sale to Wal-Mart. The Agreement provided a “*nontransferable* license to utilize and exploit the Licensed Marks . . . in connection with the manufacturing, sale . . . and after sales service of the Goods . . . .” *Id.* at 162.

<sup>115</sup> See, e.g., *E & J Winery*, 247 F. Supp. 2d at 974–75 (describing a wine distribution agreement that was not assignable by the wine producer); *Quality Healthcare Equipment*, 1996 WL 604059, at \*1 (bed distribution agreement not assignable by the manufacturer); *Hannex*, 140 F.3d at 197 (camera distribution agreement not assignable by manufacturer).

<sup>116</sup> See, e.g., sources cited *supra* note 115 (describing agreements concerning wine, underwater cameras equipment, and therapeutic beds that are not freely assignable).

<sup>117</sup> See, e.g., *Fidelity & Guaranty Life Ins. Co.*, *supra* note 113, § 18.A (permitting assignment of an insurance producer's agreement between an insurer and selling agent by the insurer); *PDV Midwest Refining LLC v. Armada Oil & Gas Co.*, 116 F. Supp. 2d 851 (E.D. Mich. 2000) (describing a gas distribution contract under which the upstream supplier's rights and duties were assignable).

agreement to transfer a good at a particular price — than in unspecified conduct. Therefore, the possible harm that could occur from an assignment is lower because the original contracting party is not expected to provide performance above and beyond the specified obligations that could be enforced against an assignee. These contracts are thus somewhat likely to be assignable.<sup>118</sup> However, there remain other reasons besides unassignable performance that may lead a party to a supply contract to prefer the original counterparty to an assignee — for example, faith in the financial soundness of the counterparty, which implies that the counterparty will fulfill the contract obligations.<sup>119</sup> Thus not all such supply contracts are freely assignable.<sup>120</sup>

#### **d) Patent Licenses**

Patent licenses resemble vertical business relationships: the patentee provides the licensee's input — technical information and permission to use it — which the licensee incorporates into its product. Patent licenses can compensate the patentee in several ways: a royalty scheme such as a percentage of revenues or a fixed royalty per unit sold; or a royalty-free license involving a one-time payment up front. Under both compensation schemes, the model of unassignable elements of performance applies, and is likely to lead parties to restrict assignment by the licensee.

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<sup>118</sup> In *KN Gas Supply Services, Inc. v. Am. Production*, 994 F. Supp 1283 (D. Colo. 1998), KN Energy agreed to purchase an annual minimum quantity of gas from American Production. *Id.* at 1285. The contract stated that it “and each of its covenants and obligations shall inure to the benefit of and be binding upon the parties . . . and upon their respective successors and assigns . . .” *Id.* at 1286. This contract was assignable by either party because under clearly established Colorado law, which governed the contract, “parties may agree to make an otherwise unassignable contract assignable by insertion of a ‘successors and assigns’ provision.” *Id.*

In *In re Neuhoff Farms, Inc.*, 258 B.R. 343 (Bankr. E.D.N.C. 2000), Neuhoff Farms entered a “hog partnership agreement” with Hatfield Quality Meats, Inc., under which Neuhoff was to supply Hatfield with approximately 200,000 market hogs per year. *Id.* at 345. The contract was silent on assignability, but the court held the contract to be assignable as a sale of goods contract which provided a homogeneous product, meaning that assignment would not jeopardize the purchaser's rights in the contract. *See id.* at 351.

<sup>119</sup> This issue is particularly important for long-term contracts.

<sup>120</sup> *See, e.g., Hess Energy, Inc. v. Lightning Oil Co.*, 276 F.3d 646 (4th Cir. 2002) (Natural gas supply contract: not assignable without consent; which will not be unreasonably withheld. Assignment permitted to successor/purchaser of entire business); *Midwest Grain Prods., Inc. v. Envirofuels Marketing, Inc.*, 1996 WL 445070 (D. Kan. 1996) (gas supply contract not assignable).

*Royalty-Bearing Licenses.* Licenses that involve royalties resemble franchise relationships and distributorships: the patentee supplies the licensee and relies for its income on the licensor's success in making and distributing a product. "Licensors [choose] their licensees according to the licensee's ability to perform," valuing their ability to exploit the patent and to achieve financial success.<sup>121</sup> The "licensor would not be happy to see the license assigned to an inappropriate, incompetent, or insolvent assignee."<sup>122</sup> Because business success in production, marketing and distribution will be costly to specify (both because it is difficult and because it is better to grant the licensee flexibility), the licensor is likely to rely upon the identity of the licensee as a proxy for predicting the desired conduct. To the extent that a licensee not approved by the licensor would not be able to deliver this unspecified performance, an assignment could cause significant harm to the licensor. Therefore, we should expect to see that many royalty-based patent licenses are non-assignable.<sup>123</sup>

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<sup>121</sup> MARK S. HOLMES, PATENT LICENSING, § 15:1.1, at 15-2 (PLI Dec. 2002).

<sup>122</sup> *Id.*

<sup>123</sup> See, e.g., *Epic Sys. Corp. v. Allcare Health Management Sys., Inc.*, No. 4:02-CV-161-A, 2002 WL 31051023, \*1 (N.D. Tex. Sept. 11, 2002) ("[P]laintiff and defendant entered into a license agreement pursuant to which plaintiff pays *annual royalties and additional royalties* to defendant for a nonexclusive, *nontransferable*, limited [patent] license . . ."); *Biagro Western Sales Inc. v. Helena Chem. Co.*, 160 F. Supp. 2d 1136, 1139 (E.D. Cal. 2001) (describing a patent license under which the licensee paid royalties, which stated: "This Agreement . . . shall be personal to the Licensee and assignable by the Licensee only with the written consent of The Regents, which consent shall not be unreasonably withheld.").

*Matsushita Electric Indus. Co. v. Cinram International, Inc.*, 299 F.Supp.2d 348 (D. Del. 2004) describes a consortium of companies that created a patent pool of those patents needed to produce DVD technology. The members agreed to license the pooled patents; the licenses stated: "Licensor hereby grants to Licensee and its affiliates a non-exclusive, non-transferable license to make, have made, use, sell, and otherwise dispose of DVD products under the DVD Patents . . ." *Id.* at 357 One licensee, Cinram, paid \$4.87 million for a license, and agreed to pay running royalty payments of \$0.05 per DVD made. *Id.* at 354 n.2.

In *Abbot Laboratories v. Baxter International Inc.*, No. 01 C 4809, 2002 WL 467147 (N.D. Ill. Mar. 27, 2002), a patentee, Baxter, licensed its "Patent and Know-how" rights to Maruishi, who had "commercially developed sevoflurane with great success in Japan." *Id.* at \*1 The license contemplated a sublicense of the intellectual property between Maruishi and Abbott, who would market sevoflurane in those territories where Maruishi did not do business. The agreement provided for royalty payments to Baxter based on the quantity of sevoflurane sold to Abbott, and also based on Abbott's average selling price of the licensed products. *Id.* at \*2. The agreement between Maruishi and Abbott contained "an exclusive, non-transferable licence in the territory under the Intellectual Property Rights and the Improvements, to sell Sevoflurane . . ." *Id.* at \*3.

It should be noted that nonexclusive patent licenses, including those with royalty payments, are deemed by courts to be “personal” and non-transferable by default.<sup>124</sup> One might argue that a nonexclusive license would answer the concerns about harm to the non-assigning licensor because a patentee seeking to maximize its income could simply issue enough nonexclusive licenses to ensure a high output of products at the desired royalty rate.<sup>125</sup> And some royalty-bearing nonexclusive licenses are transferable.<sup>126</sup> However, transaction costs of negotiating a large number of licenses (and negotiating new ones if existing licenses get transferred to undesirable assignees), monitoring a potentially large number of assignments, and the fact that having too many licensees may cause the licensees to operate at below an efficient scale, may make this an undesirable alternative; as may the desire to minimize the spread of detailed technical information to potential competitors who can innovate around or beyond the patent.

To the extent that harm by assignment of a royalty-bearing license is likely to be caused by a transfer from a licensee more competent at exploiting the patent to one who is less competent, this harm is mitigated to the extent that the transfer accompanies the sale of the

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In *Verosol B.V. v. Hunter Douglas, Inc.*, 806 F. Supp. 582 (E.D. Va. 1992), the owner of a patent for curtain screens granted a window-covering manufacturer and distributor a “personal, non-exclusive, non-transferable right and license under the [patent] for Hunter-Douglas to itself manufacture, assemble and sell blinds or have its fabricators assemble and sell its blinds . . . .” The Agreement required the licensee to pay royalties based on quarterly reports regarding sales of products. *Id.* at 584.

In *Collins & Aikman Corp. v. Compo Industries, Inc.*, Civ. Action No. 6098, 1982 WL 17804 (Del. Ch. July 6, 1982), Pandel developed a valuable carpet backing for C & A, a carpet manufacturer, and issued C & A an “exclusive, non-transferable, royalty-bearing license” of Pandel’s “Patent Rights and Know-how.” *Id.* at \*3 (emphasis removed). C & A was to make \$50,000 in initial payments to Pandel, along with an annual royalty based on percentages “‘of C & A’s net selling price’ of the ‘material processed under the Know-how and Patent Rights.’” *Id.*

<sup>124</sup> See, e.g., *Everex Systems, Inc. v. Cadtrack Corp.*, 89 F.3d 673, 679 (9th Cir. 1996) (“Federal law holds a nonexclusive patent license to be personal and nonassignable . . . .”); *Stenograph Corp. v. Fulkerson*, 972 F.2d 726, 729 n.2 (7th Cir. 1992) (“Patent licenses are not assignable in the absence of express language.”).

<sup>125</sup> Cf. KAPLOW & AREEDA, *supra* note 102, § \_\_, at \_\_ (observing that the profit-maximizing industry structure for a monopolist manufacturer is to have enough retailers so that they are in perfect competition and receiving no economic profits).

<sup>126</sup> See, e.g., *WMS Gaming Inc. v. International Game Technology*, No. 94 C 3062, 1996 WL 539112, \*9 (N.D. Ill. Sept. 20, 1996) (describing a patent with several licensees, at least one of which, Bally Gaming, paid royalties and had a transferable license).

licensee's entire business, including assets and sales force.<sup>127</sup> Thus, some patent licenses are likely to be assignable with transfers of the licensee's business.<sup>128</sup>

*Royalty-free licenses.* Royalty-free licenses, or licenses where the licensee pays a one-time lump sum for the right to use a patent, does not involve the same potential harm to the non-assigning party as do royalty-bearing licenses and other vertical relationships — the unspecifiable performance of being a “successful licensee.” Because the licensor has no future income flowing from royalty payments, one might expect the licensor not to care about potential assignees.

However, the licensor may be concerned about limiting competition from the licensee: a licensor who gave a royalty-free license to a small company would be harmed were the license transferred to a larger entity that competed much more but paid no more.<sup>129</sup> The licensor may seek a promise to limit competition from the licensee, such as by permitting a licensee to participate in markets not central to the licensor's business, or to limit the licensee to a certain volume of competition. However, a volume-capping promise may be costly to specify because the parties do not want to stifle the licensee's business flexibility by precisely limiting them. A field-of-use restraint may be effective if the licensor's industry is separate from the licensee's industry (though the technology applicable in both), meaning that there could be no competitive harm from an assignment.<sup>130</sup> But such restraints may not work if technology is changing or the definition of fields is uncertain.<sup>131</sup> If the licensor is considering having additional licensees,

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<sup>127</sup> See HOLMES, *supra* note 121, § 15:1.6, at 15-5.

<sup>128</sup> See *id.* (providing an example clause that reads: “Neither this Agreement nor any right or obligation hereunder shall be assignable by either Party without prior written consent of the other ... provided, however, that Licensee may assign this Agreement without such consent in connection with the sale of substantially all of its business to which this Agreement relates.”).

<sup>129</sup> See *Everex Sys., Inc. v. Cadtak Corp.*, 89 F.3d 673, 679 (9th Cir. 1996) (“any license a patent holder granted ... would be fraught with the danger that the licensee would assign it to the patent holder's most serious competitor”); JAY DRATLER, JR., LICENSING OF INTELLECTUAL PROPERTY, § 1.06[2][a], at 1-50.24 to 1-51 (2003).

<sup>130</sup> In *Donovan v. ABC-NACO Inc.*, No. 02 C 1951, 2002 WL 1553259 (N.D. Ill. July 15, 2002), a patentee of explosives technology sold his patent to ABC-NACO, a company in the railroad business. *Id.* at \*1. As part of the transaction, the company granted him back a “paid-up, royalty-free, fully assignable license to use the Patent Rights in all fields having to do with the destruction of explosive, chemical, or biological weapons,” a business that ABC-NACO was not in. *Id.*

<sup>131</sup> See DRATLER, *supra* note 129, § 1.06[2][a], at 1-51.

moreover, future licensees will pay for them only if their market is not already taken by an earlier licensee or its assignee. Thus it is difficult to generalize about royalty-free licenses: depending on the particular scenario of the parties, some are likely to be freely assignable, while some are not.<sup>132</sup>

For *exclusive* royalty-free licenses, however, the considerations urging against assignability should be less important: the licensor is not itself in the business and should not be worried about competition; and a licensor of an exclusive license should not be worried about extracting value from add-on licensees in the future. The licensor simply sets the price at which it wants to sell what is essentially an entire business — it has no continuing interest once the license issues, and thus cannot be harmed.

#### e) Leases

A tenant's ability to assign his interest in a lease without obtaining the landlord's consent is a familiar question in assignability practices.<sup>133</sup> Many but not all leases restrict assignability, although both the incidence of assignment restrictions and parties' incentives vary considerably with the kind of lease involved.

*Residential Leases.* Like all leases, a landlord cares about a residential tenant's performance of his or her duty to pay rent. In addition, the landlord cares about a tenant's treatment of the property and easy interaction with neighbors. It is difficult to specify, monitor, and enforce such non-payment aspects of performance: a landlord (who would like the property in good condition for her own future use or the next tenant's use) would like the tenant to be generally attentive and not impose upon it too much wear and tear. But beyond prohibiting pets and prohibiting actually damaging the apartment, which can be specified with ease and enforced

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<sup>132</sup> Compare, e.g., *Donovan*, 2002 WL 1553259 (assignably royalty-free license), with *Everex Systems, Inc. v. Cadtrack Corp.*, 89 F.3d 673, 674–75 (9th Cir. 1996) (describing a “royalty-free, worldwide, nonexclusive,” license of a computer-graphics patent, under which the licensee paid a one-time \$290,000 royalty, and which was non-transferable).

<sup>133</sup> Assignments, in which the tenant transfers his entire remaining interest in a lease to a new party, and subleases, in which the tenant does not transfer his entire remaining interest, are legally distinct. Practices for subleasing generally seem to track practices for assignment, so I will not make much of this distinction.

in court or by self-help,<sup>134</sup> general inattentiveness will comply with lease terms as well as general attentiveness. Thus if a landlord finds a responsible adult who will take care of the premises, there is a harm to the landlord in substituting a less premises-conscious tenant — such as a recent college graduate — who will deliver a less valuable performance within the range of contractually permissible conduct.

Similarly, the landlord will want someone who is congenial to live near — for example, a person who lives quietly with a daytime job rather than a rock band member who works at night and may disturb neighbors. Some leases may attempt to specify some aspects of interaction-with-others behavior by limiting parties or alcohol consumption,<sup>135</sup> but monitoring and enforcing even these provisions may be difficult, and there are many more subtle and personal aspects to tenant interaction that cannot be captured in a lease. Thus both congenial tenants and disturbing tenants will be in compliance with the terms of the lease, though the lease will be more valuable to the landlord if the tenant is of the former type.

Thus harm to the landlord will arise from an assignment from a “congenial” to a “disturbing.” If the person is living in the landlord’s home the substitute may cause grief directly to the landlord, or if living near other tenants the substitute may make those tenants unhappy and less willing to pay for their leases (or less willing to recommend the landlord to others).

As a result of these features of residential leasing, we would expect residential leases to contain restrictions on assignability. While many states regulate the extent to which certain kinds of residential leases can limit the right of assignment or subleasing — such as by preventing landlords from unreasonably withholding consent<sup>136</sup> — many leases restrict

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<sup>134</sup> See Lease between William L. Lower and Jennifer Colasuonno et al. for Apartment in a Multi-Apartment House in Ithaca, N.Y. ¶ 5 (Nov. 14, 1994) [hereinafter Ithaca Apartment Lease] (on file with author) (“The tenant will keep no animals, birds or other pets . . . . The tenant will reimburse the landlord for any expenses incurred by the landlord in repairing damage caused by the act or omission of the tenant or guests . . . .”); *id.* ¶ 20 (“If Tenant(s) shall fail to comply with the requirements for vacating or surrendering premises in original condition, less normal wear and tear, Tenant(s) agrees Landlord may deduct from the Security deposit an amount for labor, materials, and supplies . . . .”).

<sup>135</sup> See, e.g., *id.* ¶ 18 (“Tenants agree that they will not engage in any social activity insider or outside the demised premises which is attended by more than 3 persons at which alcoholic beverages are served or consumed.”).

<sup>136</sup> See, e.g., N.Y. Real Prop. Law § 226-b(1) (McKinney 2001) (“Unless a greater right to assign is conferred by the lease, a tenant renting a residence may not assign the lease without the written consent of

assignment and subleasing as much as legally permissible. This is observed, for example, in leases of apartments in college-town houses,<sup>137</sup> of units in more professionally managed multi-unit buildings,<sup>138</sup> and of plots in mobile home parks.<sup>139</sup>

*Commercial Leases.* A commercial landlord's interest in ensuring that it has a creditworthy tenant who will fulfill a specified rent obligation is strong and may lead to some restrictions on assignment.<sup>140</sup> Yet several of the unspecifiable but desired performances that play a role in residential leases are much less important in the commercial context. First, to the extent

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the owner . . . .” Should the landlord withhold consent unreasonably, the tenant may terminate the lease with thirty days notice.); *id.* § 226-b(2)(a) (“A tenant renting a residence . . . in a dwelling having for or more residential units [may] sublease his premises subject to the written consent of the landlord . . . . Such consent shall not be unreasonably withheld.”)

<sup>137</sup> See, e.g., Lease, *supra* note 134, ¶ 8 (“The tenant . . . will not transfer or assign this agreement or sublet . . . to any person or persons or suffer to be used by other[s], said premises . . . without first obtaining the written consent of the landlord, and only then under conditions as set forth by the landlord . . .”).

<sup>138</sup> Bankier Apartments, Lease Contract, <http://www.bankierapts.com/documents/lease.pdf> (“Lessee agrees not to assign this lease, nor sublet premises, or any part thereof without the consent of the Lessor. Lessee agrees to sublease only by using the sublease agreement on the last page hereof. Lessee further agrees to assign this lease only by written agreement with Lessor and agrees to pay a \$35.00 sublet fee.”). *WG Assocs. v. Estate of Roman*, 753 A.2d 1236 (N.J. Super. App. Div. 2000) (describing the lease of an apartment which stated that the “apartment may not be occupied by anyone other than the Tenant and his household members,” and that “[t]he Tenant may not sublet the apartment nor may Tenant assign this Lease”).

<sup>139</sup> Although the residential units in mobile home parks are independent units, the owner and rest of community may care about community image and ensuring that their tenants are consonant with the image of the community that they desire.

Edwood Estates describes itself as “[d]esigned for 55 and older, Edgewood Estates offers the quiet life with privacy and peaceful living assured. The Park incorporates unique green meadows with meandering walkways, apple orchards, picturesque ponds and an unbelievable view of Mount Shasta with her snow tip surroundings and year round glaciers.” Edgewood Estates, *The Ultimate in Fine Manufactured Home Living*, <http://www.mobile-home-park.com>. Its lot rental agreement provides: “Residents shall not sublease, or otherwise rent all or any portion of Resident’s home or the Lot. Resident shall not assign or encumber its interest in this lease or the Lot.” Edgewood Estates, *Park Rental Agreement*, <http://www.mobile-home-park.com/park-rental-agreement.html>. See also *Monmouth Mobile Home Park, Rules and Regulations*, <http://www.mmhp.com/MMHP-Rules%20and%20Regulations-Bookmarked.pdf> (“The owner or owners of any mobile home shall not sublet his or her mobile home, assign any rights as to his or her mobile home and/or the agreement to pay monthly rent or any other rights as to his or her mobile home . . .”).

<sup>140</sup> See *infra* section III.B.

that many commercial properties are rented as land<sup>141</sup> or bare walls plus plumbing,<sup>142</sup> care for the premises for landlord or future tenant use probably takes a back seat. Similarly, where commercial leases are longer than one-year residential leases<sup>143</sup> and often conceive of extensions,<sup>144</sup> the landlord's valuation of its faraway residual possession is less important. Second, "behavior" in terms of interaction with neighbors is either less of an issue with businesses. If there are any concerns they probably arise from the nature of the business and not individual conduct<sup>145</sup> and can be effectively handled through use-restriction clauses.<sup>146</sup> Thus there is not such a range of value of performance within the contractually permissible range. Tenant assignment in the commercial context is therefore unlikely to impose significant harm on a landlord on these non-payment dimensions.

Special concerns about potentially differing values of performance in leases to retail tenants also turn out not to be a problem requiring restrictions on assignment. The owner of a shopping center will desire that tenants engage in a variety of businesses, both as a means of attracting customer traffic and to prevent cannibalization. In many instances this can again be achieved with a proper application of use restrictions,<sup>147</sup> so this component of desired

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<sup>141</sup> See JEROME D. WHALEN, *COMMERCIAL GROUND LEASES* § 1:1, at 1-1 to -2 (2d ed. & rel. Apr. 2003).

<sup>142</sup> See Josh Holusha, *Small Spaces Make Up Growing Share of Leases*, N.Y. TIMES, Mar. 7, 2004, § 11, at 4 (noting that in office space leases, the typical practice is that "vacated office space is demolished back to the basic structure of the building" and that "[p]rospective tenants typically have to figure out to use the raw space").

<sup>143</sup> See, e.g., *Real Estate Investors Four, Inc., v. Am. Design Group Inc.*, 46 S.W.3d 51 (Mo. App. 2001) (describing a five-year lease of shopping center property); *1010 Potomac Assocs. v. Grocery Manufacturers of Am., Inc.*, 485 A.2d 199, 203 (D.C. App. 1984) (describing a ten-year office space lease).

<sup>144</sup> See *1010 Potomac Assocs.*, 485 A.2d at 203 (describing five-year extension option), may also mitigate this concern: the long periods may mean that there are fewer lease "ends" during which the landlord must worry about a tenant's diminishing incentives to care for the property that will soon no longer possess.

<sup>145</sup> See, e.g., *1010 Potomac Assocs.*, 485 A.2d at 203 n.2 (noting an office-space lessee's concern "that its employee recruiting not be retarded by conditions of 'porno shops and prostitutes right outside the door' . . . and that 'head shops and that sort of thing' not become neighboring tenants").

<sup>146</sup> Cf. Ira Meislik, *Introduction to All Retail Leases Are Not Alike! How They Differ Depending on the Nature of the Retail Project*, in 3 *THE COMMERCIAL PROPERTY LEASE* 75, 83 (Patrick A. Randolph, Jr. ed., 1993) ("Commonly applicable provisions are those that bar nonretail uses [and] 'immoral' uses . . . .")

<sup>147</sup> See Meislik, *supra* note 146, at 82-84.

performance is relatively easy to specify, monitor, and enforce.<sup>148</sup> The landlord of a standalone property lacks even these concerns: the landlord has no concern about generation of traffic generally,<sup>149</sup> and the concern is merely one of rent revenue from that particular store.

Thus, the predominant interest of the landlord in a commercial lease is making sure it has a tenant who will pay the rent — a fixed and not an unspecified or unspecifiable performance obligation. Note that there may be a joint-venture or vertical-business-relationship component to the enterprise for retail space leases that contain percentage rent provisions,<sup>150</sup> which would lead to landlord concerns about making sure that any assignee would be as likely to be as successful in business as the originally chosen tenant. But this may be weakened because of the existence of minimum rent<sup>151</sup> (and absent where there is no percentage rent obligation) and is weaker than the intangible success factor in franchise relationships because the tenant is not responsible for the enterprise's brand goodwill.

Thus, while the unspecifiable expected performance from a commercial tenant can be a concern, it is not overwhelming. Moreover, the long term of many commercial leases may make a tenant concerned about its flexibility should conditions change in several years: its own valuation of the lease may drop substantially after a time, and the right to bail out and find a new tenant who values the lease highly may be particularly valuable to a long-term tenant. So while we may not expect free assignability to be the dominant mode in commercial leases — and many commercial leases are not assignable without landlord consent (which often cannot be

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<sup>148</sup> An exception to this generalization will occur when there is a tenant with a special reputation, such as a high-quality brand, that will uniquely attract customers for the benefit of all tenants (and thus the landlord). This is more often a concern in regional shopping malls than in local shopping centers or strip malls. See Meislik, *supra* note 146, at 82, 85. Reputation in this capacity will be discussed *infra* section III.A.3.

<sup>149</sup> See Meislik, *supra* note 146, at 85–86.

<sup>150</sup> See, e.g., *Plaza Associates v. Unified Development, Inc.*, 524 N.W.2d 725, 728 (Minn. App. 1994) (“The lease provided for a fixed base rent of \$708.33 per month plus a percentage rent equivalent to the amount by which three percent of Walgreen's cash receipts from sales exceeded the annual fixed rent.”); see also WHALEN, *supra* note 141, § 1:4.1–4.2, at 1-9 (describing percentage rents in ground leases as a means of providing “fair returns to the landowner based on the profitability of the project, while protecting the developer's ability to finance, operate, and refinance the project”).

<sup>151</sup> See WHALEN, *supra* note 141, § 1:4.1, at 1-8 (noting that the “minimum rent usually represents a fair rate of return on the value of the land at the time the lease is signed”).

unreasonably withheld) in the retail space domain,<sup>152</sup> in the lease of office space,<sup>153</sup> and in the leasing of other commercial property,<sup>154</sup> including long-term ground leases<sup>155</sup> — we may also expect to see a number of leases that are assignable. Thus there are many retail space leases that give broad assignment and sublease rights to the tenants.<sup>156</sup> The same is true of some other commercial property leases.<sup>157</sup>

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<sup>152</sup> See, e.g., *In re Stanley Station Assocs., L.P.*, 179 B.R. 682, 684 (Bankr. D. Kan. 1995) (describing a twenty-year lease of strip mall space); *Real Estate Investors Four, Inc. v. Am. Design Group Inc.*, 46 S.W.3d 51, 55 (Mo. App. 2001) (describing a lease of shopping center property restricted to “no other purpose or business than that of retail and/or wholesale use of furs and/or jewelry and/or other fashion items” that was “not assignable and prohibited subletting without the written consent of the lessor”); *Fernandez v. Vasquez*, 397 So. 2d 1171, 1172 (Fla. App. 1981) (describing a five-year lease to a bakery providing that “lessee shall not assign the lease, nor sublet the premises without the written consent of the promisor”).

<sup>153</sup> See, e.g., *1010 Potomac Assocs.*, 485 A.2d at 203 (describing a ten-year office space lease that provided that the tenant “could sublet or assign ‘the demised premises or any part thereof’ only with the written consent of the landlord, ‘which consent shall not be unreasonably withheld’”).

<sup>154</sup> See, e.g., *M.R. Wachob Co. v. MBM P’ship*, 656 A.2d 1036, 1038 (Conn. 1995) (describing a fifteen-year lease of a commercial office building, which permitted the tenant to assign or sublease only with the consent of the landlord, “which could not unreasonably withhold its consent”); *Kendall v. Ernest Pestana, Inc.*, 709 P.2d 837, 840 n.5 (Cal. 1985) (describing a lease for airport hangar space providing that “[l]essee shall not assign this lease, or any interest therein, and shall not sublet the premises or any part thereof . . . without written consent of Lessor” (internal quotation mark omitted)).

<sup>155</sup> See, e.g., *In re American Appliance*, 272 B.R. 587, 590 (Bankr. D.N.J. 2002) (describing a twenty-year ground lease, where tenant was to demolish the existing structure and construct an appliance store, which provided that “[l]essee shall not mortgage, assign, pledge, or otherwise encumber its interest hereunder . . . without the express written consent of Lessor”).

<sup>156</sup> In *Stanley Station*, a strip mall owner leased space for twenty years to a tenant, who did not itself operate a store but subleased the space to a supermarket, for payment that contained both fixed and percentage rent components. 179 B.R. at 684. The lease gave the tenant “an absolute right to assign and sublease without [the landlord’s] consent.” *Id.*

In *Plaza Associates v. Unified Development, Inc.*, 524 N.W.2d 725 (Minn. App. 1994), a shopping center owner leased space (in several successive periods of ten years or more) to Walgreen. The property was restricted in use to a drugstore, *see id.* at 728, 730, but otherwise “Walgreen could assign or sublet the leased premises . . . without the consent of Duluth Plaza.” *Id.* at 728.

In *Astro Realty Trust v. Revco D.S., Inc.*, No. 95898, 1998 WL 1181910 (Mass. Super. Ct. Jan. 16, 1998), the owner of a building with three first-floor stores granted a ten-year lease to a tenant with annual and percentage lease components. *Id.* at \*1, 3. The tenant had the “right to sublet . . . or to assign this Lease to any party or parties without the consent of the Landlord,” provided that it could not assign or

## f) Merger Agreements

Other contractual relationships that could result in a large harm to the non-assigning party are merger and acquisition agreements, which in practice are not assignable.<sup>158</sup> The fundamental performance that each party desires from the other up until the closing of the transaction is “whatever will maximize the possibility of a successful merger” and “whatever will not seriously affect the company’s value.” Successful performance cannot be specified, and moreover is the kind of performance where business flexibility is required and thus over-specification would be costly.

It should be noted that each party attempts to codify its expectations of the other in merger agreements’ “representations and warranties.”<sup>159</sup> But given the complexity and shifting

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sublease to a business that violated the “exclusives granted to other tenants . . . or uses then being conducted by other tenants.” *Id.* at \*2.

<sup>157</sup> *See, e.g.*, Edgar Benjamin Fontaine Testamentary Tr. v. Jackson Brewery, 847 So. 2d 674, 676 (La. App. 2003) (describing a 99-year lease of land plus improvements including a shopping center, which provided that “Lessee . . . may assign, sub-lease, convey, transfer, or mortgage, its leasehold estate or this lease, without the written consent of the Lessor”); Hill v. Osborne, No. E1999-00365-COA R3-CV, 2000 WL 337550, \*1 (Tenn. Ct. App. Mar. 30, 2000) (describing a ten-year lease with several renewal options of a “parcel of improved property” to a group of doctors, which provided that “Lessees from time to time may assign this lease or sublet all or any part of the premises”); Lehrer v. Waste Management of Wis., Inc., No. 91-0730-FT, 1991 WL 198191, \*1 (Wis. Ct. App. Aug. 27, 1991) (describing a five-year lease of real estate to Waste Management, which had the right to assign the lease).

<sup>158</sup> *See, e.g.*, Agreement and Plan of Merger By and Among Bell Atlantic Corp., Verizon Ventures I Inc., Verizon Ventures II Inc., and NorthPoint Communications Group, Inc., § 10.8, at 79 (Aug. 7, 2000) [hereinafter Verizon Merger Agreement] (“This Agreement shall not be assigned by operation of law or otherwise without the prior written consent of the other Parties hereto . . . .”), *available at* <http://www.stockskill.net/NPNTQ/merger-agreement.html>; Agreement and Plan of Merger Among Equity Office Properties Trust, EOP Operating Limited Partnership, Speiker Properties, Inc. & Speiker Properties, L.P., § 8.7, at 58 (Feb. 22, 2001) [hereinafter Equity Office Merger Agreement] (“Neither this Agreement nor any of the rights, interests or obligations under this Agreement shall be assigned or delegated, in whole or in part, by operation of law or otherwise by any of the parties without the prior written consent of the other parties.”), *available at* <http://techdeals.startup.findlaw.com/agreements/eop/spieker.mer.2001.02.22.html>

<sup>159</sup> The NorthPoint-Verizon merger agreement contains twenty pages of representations and warranties by NorthPoint and Verizon concerning such topics as capitalization, litigation it was involved in, employee benefits matters, labor matters, environmental matters, intellectual property and insurance. *See* Verizon Merger Agreement, *supra* note 158, arts. IV–V, at 21–41; *see also* Equity Office Merger Agreement,

nature of any business, it is often necessary to soften these enumerations, by requiring only that a party's representations not be untrue in any way that would have a "material adverse effect" on that party.<sup>160</sup> Any attempt here to contract into the desired performance of a successful merger is further softened by the fact that the "material adverse effect" standard has been interpreted as a high bar to meet.<sup>161</sup> The result is that although some up-front contracting costs are expended to ensure that the parties behave in an appropriate way to effect a mutually beneficial merger, these provisions are costly and difficult to enforce. As a result, there ends up being a very wide range of performance that is in practice contractually permissible — and this performance can go from being very valuable to the other party (the company acquires valuable new business between signing and closing) to being very costly to it (key employees leave between signing and closing).

Thus in practice each party closely investigates the business of the other party, and comes to the conclusion that the other is an appropriate transaction partner and therefore is confident that the other party will render the desired but unspecifiable performance. Were one party — expected to deliver a high-value performance within the contractually permissible range — to assign its interest in an M&A agreement to an unvetted third party, the non-assigning party would face a merger with an untested party. This may cause substantial harm to the non-assigning party, since the new partner's performance may be a low-value one within the contractual range. Were one party to assign its interest in an M&A agreement to an unvetted

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*supra* note 158, arts. 2–3, at 11–34 (setting forth representations and warranties of both parties to the merger).

<sup>160</sup> See Verizon Merger Agreement, *supra* note 158, § 8.2(a), at 67 (“The representations and warranties of Verizon contained in this Agreement shall be true and correct on the date hereof and . . . shall also be true and correct on and as of the Closing Date, . . . provided, however, that for purposes of this Section . . . only, such representations and warranties shall be deemed to be true and correct unless the failure or failures of such representations and warranties to be so true and correct . . . , individually or in the aggregate, results or will result in a Material Adverse Effect on Verizon”); *id.* § 8.3(a), at 68; Equity Office Merger Agreement, *supra* note 158, §§ 6.2(a), 6.3(a), at 51, 52.

<sup>161</sup> See *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001) (“[E]ven where a Material Adverse Effect condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquirer.” (footnote omitted)).

third party, this performance might not be delivered, imposing a large harm upon the non-assigning party who would face a merger with an untested entity. Thus, one would correctly expect merger agreements, asset purchase agreements, and the like, not to be assignable.

**g) After-Arising Information Asymmetries (Health Club Memberships)**

One situation where one party may lack specific information about the other, but still believes that on average assignees' conduct will make them more costly than the initial parties to deal with is when restrictions on assignment prevent one party from taking advantage of an information asymmetry that arises *after* the time of contracting. The parties may begin with symmetric information about how one party will behave, but this may change over time. Consider contracts where a promisor must provide as much service as the promisee demands (gym contracts, ski tickets), and where the demand is left to the promisee's unspecified discretion. A promisee may not initially know how much he will demand, but with time may learn whether he will want to use a lot or a little. Promisees who demand more are more costly to the promisor and will more highly value the contract. So if a promisee learns that he is a low-demand promisee, he will realize his contract rights are less valuable to him than to many others, and he will want to assign.

The expected cost of the promisor's performance to any initial promisee is based on some cross-sectional average of the population — like users and heavy users alike who don't yet know how much they will use. But the typical assignment will replace a low use promisee with a high use promisee, and thus harm the promisor. This logic may partly underlie the fact that many health club memberships are not assignable.<sup>162</sup> Many new customers sign up not knowing whether they will work out often or not. Those who come often are more costly to the club, and clubs probably set their price (to new customers at least) expecting that a certain proportion of their members will be infrequent users. Permitting assignments of memberships could create problems because as users gain information about themselves, the membership will shift from infrequent users toward frequent users, increasing cost.

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<sup>162</sup> See, e.g., *Xu v. Gay*, 668 N.W.2d 166, 171 (Mich. App. Ct. 2003) (“Membership and daily fees are neither refundable nor transferable”); *Midway Fitness & Raquetball, Gym Memberships*, at [http://www.midwayfitness.com/Midway\\_Pages/gym\\_memberships.htm](http://www.midwayfitness.com/Midway_Pages/gym_memberships.htm) (last visited Mar. 28, 2004); *Bally Total Fitness, Membership Plans*, at [http://www.ballytotalfitness.com/join/membership\\_plans](http://www.ballytotalfitness.com/join/membership_plans) (2003) (listing eight plans, of which four are non-transferable).

## **h) Insurance**

In insurance policies, assignment of the promisee's (insured's) rights relates to the how assignment affects the promisor's (insurer's) cost of performance. Many kinds of insurance contracts do not or cannot specify certain conduct of the insured; nevertheless, the insurer's expected cost of performance is based on its expectation of how the insured will behave.

In the case of property insurance such as fire insurance, part of the risk that insurers bear is based on the characteristics of the property itself.<sup>163</sup> Since the expected cost of performance will certainly vary among properties covered — it is more costly to insure a low-elevation property against flooding than a high-elevation property — property insurance policies will be “fixed” to the property and assignment of a policy is taken to mean the transfer of an insurance policy along with the underlying interest in the insured property to a new owner.<sup>164</sup>

In this realm, the insurer-promisor's obligation is not fixed, but is contingent upon the conduct of the insured relating to the property. This conduct is not typically restricted by the terms of the insurance policy,<sup>165</sup> perhaps because it is too costly to specify the low-risk behavior that the insurer would like from an insured, but also because it is too costly to sacrifice the flexibility of one's residential life or business conduct. The result is that there is a range of performance — of various levels of risk and thus of various cost to the insurer — that is contractually permissible. Rather than microscopically specify the desired conduct, the insurer gathers information about the property owner which it uses to predict the risk of the insured's conduct, such as (for home fire insurance) whether a home is owner- or renter-occupied, whether there is a business conducted on the premises, and whether the insured has had fire-related losses or made fire-insurance claims in the past.<sup>166</sup> From such information, the insurer will ensure that the risk of the insured's conduct will not be too high within the contractually permissible range,

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<sup>163</sup> One home fire insurance application requests information about the insured structure itself such as the year of construction, number of families it houses, what type of heating system it has, whether it is located on a hillside, and whether it is near the coast. *See* Merrimack Mutual Fire Ins. Co., Dwelling Fire Application (1981) (on file with author) [hereinafter Fire Insurance Application].

<sup>164</sup> *See* KEETON & WIDISS, *supra* note 4, § 4.1(c)(i), at 298.

<sup>165</sup> For an example of the lack of restriction on the conduct, see Insurance Services Office, Building and Personal Property Coverage Form (1983), *reprinted in* KEETON & WIDISS, *supra* note 4, app. A, at 1014, the only conduct restriction in which is a recovery limitation for those insureds who leave their property vacant, *id.* at 1018.

<sup>166</sup> *See* Fire Insurance Application, *supra* note 163.

and thus that the cost of its own performance will not be too great. A transfer of the property and assignment of the insurance policy to an unvetted assignee — someone who may lack the credentials of the original insured — may cause a substantial harm to the insurer because the assignee may engage in much more risky behavior within the contractually permissible realm, and thus raise the expected cost of the insurer’s obligation. Thus the insurer-promisor has a strong interest in the identity of the insured-promisee because of its predicted conduct,<sup>167</sup> and it is therefore sensible that property insurance policies are not assignable by the insured.<sup>168</sup>

A similar logic applies to various kinds of liability insurance. Commercial general liability (CGL) insurance for businesses covers liability for bodily injury, property damage, advertising injury, and injury to reputation or other personal rights arising from a business’s products, services, or premises.<sup>169</sup> The riskiness of a CGL insured’s conduct, which involves nothing less than all the details of the insured’s business operations, would be difficult and costly to regulate by contractual terms. The result again in a wide range of contractually permissible business conduct of differing risk and implying differing costs of performance for the insurer — from practices of aggressive negative advertisements against competitors to a policy of being very safety-conscious in product design. An insurer, based upon the information it has about the insured’s business, expects the cost to be a particular place within this range (and has presumably priced based upon this expectation) and would be harmed should the insured be replaced by

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<sup>167</sup> See JEFFREY W. STEMPEL, INTERPRETATION OF INSURANCE CONTRACTS § 13.4, at 382–83 (1994) (“[I]nsurers might indeed care more about the identities of the holders of their property/casualty policies . . . than they care about the holders of rights under outstanding life insurance policies. When a business is sold, a host of factors could arouse concern in the insurer, particularly the character of the new owner, the care of her employees, and changes in use of the property . . .”).

<sup>168</sup> See, e.g., Insurance Services Office, Inc., Dwelling Property 3, Special Form, at 9 (7-88 ed. 1988) (“Assignment of this policy will not be valid unless we give our written consent.”). Keeton and Widiss noted as a result of “the widespread influence of the New York legislation that prescribes a standard form for fire insurance, fire insurance policies have almost uniformly included a provision that an ‘assignment of this policy shall not be valid except with the written consent of this Company.’” KEETON & WIDISS, *supra* note 4, § 4.1(c)(i), at 299. New York law continues to require a standard form for fire insurance policies covering property in New York, see N.Y. INS. LAW § 3404(b)(1), which includes a term prohibiting assignment by the policyholder without insurer consent, *id.* § 3404(e).

<sup>169</sup> Robert H. Jerry, II & Michele L. Mekel, *Cybercoverage for Cyber-Risks: An Overview of Insurers’ Responses to the Perils of E-Commerce*, 8 CONN. INS. L.J. 7, 15–16 (2002).

someone whose conduct will be a more risky (and thus more costly) behavior within the permissible range.<sup>170</sup> Thus, CGL policies should not be assignable by the insured party.<sup>171</sup>

Similar is automobile insurance: the insurer gathers information about the insured (for example, age, sex, history of traffic violations) and uses this to predict the riskiness of the insured's driving conduct and thereby expected cost of performance. Assignment of the policy rights to a different driver may harm the insurer because the assignee may engage in more risky driving conduct — and this will not be a breach of any insurance contract terms because an insurance policy is incapable of governing this conduct.<sup>172</sup> Thus it is sensible that these kinds of insurance policies are not assignable by the insured driver.<sup>173</sup>

### **i) Contrast: Cost of Performance Doesn't Depend on Other Party's Conduct**

An opposite analysis applies when the promisor's expected cost of performance does not depend on the conduct or discretion of the promisee, and when the promisor is not bearing the promisee's idiosyncratic risk. An example of such a contract is marine insurance on oceangoing cargo, which protects the owner of cargo from perils at sea that could damage or destroy the cargo during transit.<sup>174</sup> Because the insurer promises compensation for loss only during transit,

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<sup>170</sup> And given the typical coverage amounts of CGL policies — often \$1 million or more per occurrence, *see, e.g., Mass. Bay Ins. Co. v. Bushmaster Firearms, Inc.*, \_\_ F. Supp. 2d \_\_, 2004 WL 1570099, at \*1 (D. Me. May 20, 2004) — the harm to the insurer from a transfer from a lower-risk business to a higher-risk business could be quite substantial.

<sup>171</sup> *See, e.g., Zurich-American Ins. Group, Commercial General Liability: Security Guard Errors and Omissions Policy*, available at [http://www.schinnerer.com/product\\_info/security/pdfs/secpl.pdf](http://www.schinnerer.com/product_info/security/pdfs/secpl.pdf) (last visited August 1, 2004).

<sup>172</sup> It is probably extraordinarily difficult to specify and enforce the myriad elements of care that go in to making a safe driver.

<sup>173</sup> *See, e.g., Bolz v. State Farm Mut. Auto. Ins. Co.*, 52 P.3d 898, 900 (Kan. 2002) (describing a personal-injury automobile insurance policy that prohibited assignment through a “Condition” in the policy that read: “No change of interest in this policy is effective unless we consent in writing.”); *Santiago v. Safeway Ins. Co.*, 396 S.E.2d 506, 507 (Ga. App. 1990) (describing a no-fault insurance policy that provided that the insured's “rights and duties under this policy may not be assigned without our written consent.”).

<sup>174</sup> *New York Marine & General Ins. Co. v. Tradeline (L.L.C.)*, 266 F.3d 112 (2d Cir. 2001), involved a marine insurance policy that covered “loss or damage due to (a) fire or explosion; (b) a stranded, grounded, sunk or capsized vessel; (c) collision of the vessel with ‘any external object;’ or (d) discharge of cargo at a port of distress,” and “rainwater damage.” *Id.* at 126. Coverage commenced “from the time

if ownership of the cargo changes during this period, the cost to the insurer of a substitute promisee should be no higher than that of the original promisee because the insured property is “outside the control of any owner.”<sup>175</sup> There is no range of contractually permissible conduct within which assignor and assignee may differ because there is no conduct element to the relationship. Thus, assignment inflicts no harm upon the insurer.

Moreover, the fact that during a long voyage there is often a robust trade in the ownership of shipped commodities<sup>176</sup> suggests that there is a significant value — that is, a premium of what a purchasing commodities trader will pay over what the selling commodities trader values the commodity at — to be gained by the promisee-insured from assignment of the policy (given that it is likely that purchasers of the cargo would want insurance with it, and could save transaction costs by not having getting insurance anew). Thus, it makes sense for the insured and the insurer to make the insured-promisee’s rights assignable, and they are often so made by providing coverage “for the account of whom it may concern.”<sup>177</sup>

Another example of assignment being permitted because the cost to a promisor doesn’t vary with the other party’s conduct is bare rights to payment.<sup>178</sup> One example is in insurance, where one must distinguish the right to be insured under a policy, and the right to receive payments once the loss has occurred. Although the coverage rights under a policy are often non-assignable, the assignment of the right to receive proceeds does not result in an increase in the

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[the cargo] left [the origin] warehouse and ‘continue[d] during the ordinary course of transit’” and terminated at delivery to the destination warehouse. *Id.* (alteration in original).

<sup>175</sup> ERIC A. WIENING & DONALD S. MALECKI, *INSURANCE CONTRACT ANALYSIS* 85 (1992).

<sup>176</sup> *See id.* (“In practice, the ownership of cargo might change several times during the weeks when it is in transit . . .”).

<sup>177</sup> KEETON & WIDISS, *supra* note 4, § 4.1(c)(iii), at 302. Such policies provide for “‘automatic’ assignment when an insured property is transferred.” *Id.*; *see also* WIENING & MALECKI, *supra* note 176, at 85 (“Insurance on oceangoing cargo usually is written so that the . . . policy may be assigned to other parties having an interest in their cargo as their interests develop.”). The insurance policy in *Tradeline* stated that it was “[f]or account of whom it may concern,” 266 F.3d at 126, which the court described as covering “anyone having an insurable interest in the insured property at the time of the happening of the loss.” *Id.* (quoting *The John Russell*, 68 F.2d 901, 902 (2d Cir. 1934)).

<sup>178</sup> I exclude from this category rights to payment like the right to payment that are entangled with future promised conduct — such as wages. In such cases, assignments separating payment rights from performance obligations have the danger of reducing the worker’s incentives to perform. *See* FARNSWORTH, *supra* note 6, § 11.4, at 714 n.3.

insurer's cost of performance. Thus, one would expect that these rights would often be assignable.<sup>179</sup> A similar example, mentioned above, is the fact that the Uniform Commercial Code has a mandatory rule preserving assignability of the right to payment for goods sold or services rendered.<sup>180</sup>

**j) Contrast: Assignment Doesn't Change Whose Conduct Is Relevant**

Another contrast is life insurance — which illustrates that even where the conduct expected or desired of a designated person involved in a contract is not specifiable, and where the cost or value of the contract to a contracting party depends on that contract, assignment will not necessarily harm the contracting party if the assignment does not substitute another person's conduct for the designated person's conduct.

The owner of a life insurance policy who contracts with an insurer is not necessarily the person whose life is insured (the “designated person”). Rather, the owner of the policy has rights such as the power to name or change beneficiaries, to change the amount of coverage, or if the life insurance policy has an investment component to borrow against the savings or surrender the policy for cash.<sup>181</sup> The insured, on the other hand, is the person whose conduct — not specified because it is too costly to contract about all the details of living that affect risk of death — and its riskiness determines the cost of the insurer's obligations. Transfer of ownership — assignment of the actual contractual rights of ownership — does not change the identity of the insured life, and does not change the person the riskiness of whose conduct determines the insurer's costs.<sup>182</sup> An assignment of the insurance policy to a new owner thus does not upset the insurer's expected

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<sup>179</sup> See KEETON & WIDISS, *supra* note 4, § 4.1(c)(3)(i) (“Insurance policies commonly do not contain any provision against an assignment of an insured's chose in action against an insurer. In the absence of a provision to the contrary in the insurance policy, an assignment of a chose in action is generally recognized as a valid transfer of the right to receive the proceeds of the insurance.”).

<sup>180</sup> See U.C.C. § 9-318(4)

<sup>181</sup> See KEETON & WIDISS, *supra* note 4, § 4.1(c)(ii), at 300.

<sup>182</sup> See *id.* § 4.1(c)(ii), at 299–300; STEMPEL, *supra* note 167, § 13.4, at 382. The separation of insured from contracting party is demonstrated by one insurance policy that notes that the policy “is the entire contract between *you* and [the Company],” Am. Republic Ins. Co., Term Life Insurance to Age 95, pt. 2, at 2 (issued May 20, 1993) (on file with author), where “*you*” is defined to refer to “the Owner of this policy,” Cover Letter to *id.*, and where the Owner (“The person named as owner of this policy . . .”) and the Insured (“The person whose life is insured under this policy . . .”) are not defined to be identical, *id.* pt. 1, at 1.

cost of performance, so owners often have considerable freedom<sup>183</sup> in assigning their ends of insurance policies.<sup>184</sup>

It should be noted that where future payments are being assigned, there is a potential for incentive effects that may alter the relevant person's conduct. As noted above, if there is a promise to pay in exchange for a promise of services, the assignment by the worker of the payment right could diminish his incentives to perform.<sup>185</sup> In life insurance, there may be some potential for moral hazard because assignment of a policy to someone other than the insured may cause that person to try to hasten the insured's death. As one commentator notes, however, "the thing insured — a human life — provides a powerful disincentive to moral hazard."<sup>186</sup> The insured's own behavior is also likely to be invariant to the ownership of the life insurance policy: a person usually places enough independent value on his or her own life for insurance not to have a big effect on how they take care of themselves.

#### **k) Contrast: Standardized Service Contracts**

Also in contrast to many of contracts described in this Part, where there were elements of the desired performance that were difficult to specify, monitor, or enforce, and where potential assignees might not perform as well as the initial promisor, many contracts in which consumers are promisees are mass marketed and standardized. Examples of such contracts are consumer services contracts involving wireless telephony, credit cards, and cable and internet services.

In such instances, the contract may specify the product in adequate detail itself or by reference to service plans or promotional details; alternatively the service may be so well understood in the market that upon specifying a few basic terms, the service provider is aware of and can be held to what it is promising to provide.<sup>187</sup> Moreover, the customer, aware of the

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<sup>183</sup> The policy favoring free assignability has largely superseded the requirement that the assignee have an "insurable interest" in the person whose life is insured. *See* STEMPEL, *supra* note 167, § 13.3, at 380–81.

<sup>184</sup> *See, e.g.,* Am. Republic Ins. Co., *supra* note 182, pt. 4, at 3 ("You may assign this policy if you file the assignment or a certified copy with us. An assignment on file will take effect on the date you sign it. When filed, your rights . . . are subject to the assignment."); Protective Life Ins. Co., Life Insurance Policy 5 (issued July 25, 2003) (on file with author) ("This policy may be assigned. However, for any assignment to be binding on the Company, the Company must receive a signed copy of the assignment.").

<sup>185</sup> *See supra* note 178.

<sup>186</sup> STEMPEL, *supra* note 167.

<sup>187</sup> Wireless telephony providers seem to use a combination of standardized definition and reference to promotional materials and "basic terms sheets" in the form of calling plans. Verizon's Customer

standardized nature of the promise being made, is unlikely to be seeking specialized performance from one particular service provider apart from the basic terms in the agreement. One commentator notes that “many transactions considered strictly personal in the past have become more transactional in nature and more akin to a sale of goods.”<sup>188</sup>

In this situation, then, the obligations of the promisor are effectively fully specified through contract terms plus any standardized product definition in the market. We would therefore expect many of these contracts to be assignable, on the side of the service provider.<sup>189</sup> Promises to provide wireless telephony service,<sup>190</sup> promises to provide relatively small amounts

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Agreement provides: “Your calling plans become part of this agreement,” and describe the calling plans as setting “[t]he prices you pay, including activation fees, monthly access fees, monthly minutes of airtime . . . prices for additional minutes, roaming charges, and any per-minute charges for long distance service.” VerizonWireless, Customer Agreement (Nov. 11, 2003), *at* <https://www.verizonwireless.com/b2c/footer/customerAgreement.jsp> [hereinafter VerizonWireless Agreement].

AT&T Wireless’s Service Agreement provides:

The price, features and options of the Service available for each Identifier on your Account depends on the calling, data or mobile Internet plan, feature or promotion selected by you when you activated or changed your Service and are described in a separate AT&T Wireless Calling Plan, Service Plan or Rate Plan (“Rate Plan”) Brochure, in feature or promotional materials, at [attwireless.com](http://attwireless.com) and/or in an AT&T Wireless Features and Services User Guide (collectively, “Sales Information”), all of which are incorporated by reference, are a part of this Agreement and were available when you activated or changed Service. To receive copies of Sales Information contact Customer Care.

AT&T Wireless Service Agreement ¶ 1, *at* [https://www.attwireless.com/personal/checkout/terms\\_of\\_service\\_print.jhtml](https://www.attwireless.com/personal/checkout/terms_of_service_print.jhtml) (last visited March 6, 2004).

<sup>188</sup> Dimatteo, *supra* note 6, at 439.

<sup>189</sup> See Dimatteo, *supra* note 6, at 436–37 (describing “fungibility” and the standardization of services as a factor militating in favor of a default rule of assignability for contracts).

<sup>190</sup> See VerizonWireless Agreement, *supra* note 187 (“You can’t assign this agreement or any of your rights or duties under it. We may assign all or part of this agreement without notice, and you agree to make all subsequent payments as instructed.”); AT&T Wireless Service Agreement, *supra* note 187, ¶ 34 (“We may assign all or part of this Agreement, without notice to you, and such assignment will not be a change to the Agreement. We are then released from all liability. You may not assign this Agreement without our prior written consent.”).

of money on demand as in credit card agreements,<sup>191</sup> and agreements to provide cable and internet services,<sup>192</sup> are frequently assignable by the service provider.

At least one court applied this kind of analysis in holding that a contract to supply hogs was assignable by default, reasoning that hogs were such a standardized product in the market that one supplier was as good as any other.<sup>193</sup>

One commentator has suggested that it is the availability of alternative providers that should lead a party to accept assignability<sup>194</sup> and one court has held that a contract to provide elevator-maintenance service was assignable by default, reasoning that elevator maintenance is a “routine commercial function” and that “[t]here are many competent competitors.”<sup>195</sup> This is in part, but not entirely, correct: the mere availability from others of an equivalent performance does not necessarily protect the promisee’s expectation of desired performance. The key is the

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<sup>191</sup> See Citibank (South Dakota), N.A., Card Agreement 14 (2003) (on file with author) (“We reserve the right to assign any or all of our rights under this Agreement without losing them.”); see, e.g., *Roberson v. Ocwen Fed. Bank FSB*, 553 S.E.2d 162, 164 (Ga. App. Ct. 2001) (describing a First Union National Bank MasterCard credit card in which the bank’s interest had been assigned to the Ocwen bank). Agreements by banks to advance customers money when they overdraw a checking account are similar to credit card agreements. The bank’s part of the agreement, which includes the promise to advance the funds, is often assignable. See Netbank, Checking Overdraft Protection Account Agreement and Truth in Lending Disclosure, [http://www.netbank.com/terms\\_cop.htm](http://www.netbank.com/terms_cop.htm) (last visited March 19, 2004) (“We may assign this Agreement and your [checking overdraft protection plan] at any time in our discretion.”).

<sup>192</sup> A 2002 AT&T Broadband Subscriber Agreement reads:

AT&T Broadband may assign its rights and obligations under this Agreement, without notice, to (i) any affiliate of AT&T Broadband, (ii) any party (or its affiliate) acquiring all or substantially all of the assets or stock, by merger or otherwise, of AT&T Broadband or any affiliate of AT&T Broadband, or (iii) to any person or entity purchasing or otherwise acquiring the broadband distribution system serving the Premises.

AT&T Broadband, Subscriber Agreement, at 21 (2002). Assignability is freely allowed insofar as the assignee has the necessary equipment to provide the service promised.

<sup>193</sup> See *In re Neuhoff Farms, Inc.*, 258 B.R. 343, 351 (Bankr. E.D.N.C. 2000) (“[T]he quality of hogs has become fairly homogenous due to packagers’ desires for a uniform product; one witness described today’s market as comprised of ‘cookie-cutter’ hogs. . . . Service could be rendered by the debtor, regardless of who was in charge, and hogs from almost any other producer would suffice.”). Note the court’s focus on the standardization of the product.

<sup>194</sup> See Dimatteo, *supra* note 6, at 436 (“if the subject matter of a contract is such that its substantial equivalent is readily obtainable from others, relief [from having to accept the performance of the assignee] is not warranted”).

<sup>195</sup> *In re Da-Sota Elevator Co.*, 939 F.2d 654, 656 (8th Cir. 1991).

absence of variation; the inability for the contract to end up in the hands of someone who could do a worse job without penalty. If there is “give” in the contractual description of the required performance, assignment could be made (the existence of some good substitutes notwithstanding) to a substitute promisor whose performance is within the range of contractual acceptability, but whose performance is not as good as that of the initial promisor. Harm to the non-assigning party is minimized (1) to the extent that the nature of performance is sufficiently standardized such that any performance below that level would be recognizable as inadequate; or (2) if virtually all of the available performers in the market are of sufficient level of quality to satisfy the expectations of the non-assigning promisee.

When we move away from mass markets and services (like cell phone service) and toward contracts for services that are tailored to the needs of the hiring party (like designing a factory), the expected performance again becomes costly to specify with great particularity, the problem of unspecifiable performance creates a range of contractually permissible performance. Thus one should expect that “contractors” — those hired to perform a special job in design, building, or maintenance — would find their contractual obligations not to be assignable.<sup>196</sup>

## **2. Continuity as a Guarantee of Desired Performance**

Section III.A.1 discussed situations where a promisee’s information about who the promisor (or promisee) was guaranteed some desired performance through signals like reputation for good work, prior experience, interviews, and qualifications like resumes or financial resources. Sometimes, however, a party may seek to restrict assignment in order to ensure that a contracting partner will perform in an unspecifiable yet desired way not because of who the performer is, but rather because the desired conduct will more likely occur if it is the same promisor (or promisee) who is performing throughout the life of the contract, rather than multiple promisors.

This category breaks into two roughly distinct subcategories. In the first, described next, it is not conduct of any particular contracting partner that matters; it is merely that contract

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<sup>196</sup> See, e.g., *ABB Energy Capital, L.L.C. v. General Growth Management, Inc.*, No. 012232, 2003 WL 21500530, at \*1 (Mass.Super. Ct., June 5, 2003) (describing contracts in which a firm agreed to “install and maintain lighting systems” at several malls for a five-year period; and which provided that “neither party may assign this Contract and the obligations contained herein without the prior written consent of the other, which shall not be unreasonably withheld”).

assignment could enable a contract to be passed back and forth between two promisees, “defrauding” the promisor by passing two customers off as one. In the second, described in sections (b) through (d), there is once again a concern about different contracting partners engaging in different behavior, but it is not differences in the characteristics of assignors and assignees that make assignments harmful. Rather, the very act of restricting assignment and increasing continuity in the contractual relationship either induces the desired behavior within the contractually permissible realm (either by forcing the party to gain expertise from the continued relationship, or by forcing the party to internalize costs like an owner) or by screening out those who will not engage in the desired behavior.

#### **a) One Customer per Contract**

One reason for restricting assignment when one party’s conduct is left unspecified or left to that party’s discretion that derives not from concerns about *who* is the contracting partner or even *what* that partner’s conduct is, derives instead from ensuring that the partner stays the same because the non-assigning party wants to avoid the cost of serving more than one customer when he entered a contract only expecting to serve one customer.<sup>197</sup>

If the performance is repetitive, delivered over time, and to be delivered upon the promisee’s demand, and if any one promisee will have periods during which she will not demand performance of the promisor, the promisor’s cost (though uncertain) will depend upon its expectations of how much a single promisee will demand.

Thus, for example, a ski mountain’s costs in operating lifts depends on a skier’s discretionary conduct — how many times each the skier rides the chairlifts — and a ski mountain probably has a good idea of what a skier’s demand on the system will be. Similarly, a fitness club’s cost of delivering on its promise to provide gym equipment depends on a gym member’s discretionary conduct — how often the member shows up to work out — and the club will have a sense of how often a typical user works out. Such promisor’s costs will go up if for each contract sold it unwittingly ends up serving two or three customers instead of one: if, for example, one skier gives her ticket to a friend while she goes inside for a lunch break; or if a gym member who works out in the morning can pass his membership to a coworker every day to work out in the

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<sup>197</sup> This concern will naturally arise in the context of assigning contract rights rather than contract obligations.

evening. So, harm to the promisor will arise if free assignment is permitted because the promisor effectively has to bear the cost of delivering performance to two promisees instead of one.<sup>198</sup>

There are several solutions to this problem. A transfer fee may suffice to prevent a second or third customer from freeriding in the gaps in the first customer's use of her contract rights. Thus, some health club memberships are transferable with a fee<sup>199</sup> — someone might be willing to pay \$25 once to take over a gym contract for six months, but “sharing” a single gym membership by passing it back and forth several times a week would be too expensive — and others are transferable only once<sup>200</sup> — so a member can sell to a higher-valuing buyer

In some situations, however, implementing a transfer fee system is impractical. For example, the potential period of performance may be too short — as in a one-day pass — to make enabling mid-period transfer worthwhile. This may be one reason that ski-lift tickets are not transferable,<sup>201</sup> although others may exist.<sup>202</sup>

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<sup>198</sup> As described above, *see supra* section II.C, this will result in the collapse of the pricing scheme and potential disappearance of the market. A promisor would have to charge more to each customer for the possibility of having to serve several people per contract. Those who actually want to use their ski lift tickets or gym memberships themselves would be unwilling to pay this surcharge; they would be unable to take advantage of their cost advantage. Instead of leaving the market, however, they can capitalize on their cost advantage by waiving their ability to assign their rights.

<sup>199</sup> Some health club memberships are transferable with a fee. *See* Renaissance Athletic Club, FAQ's: Most Common Questions, at <http://www.renaissanceathletic.com/commonfitnessquestions.htm> (last visited Mar. 28, 2004) (“Paid-in full members may sell their membership to another person for a price designated by the member. All sales or transfers require a \$25 transfer fee.”).

<sup>200</sup> *See, e.g.,* Bally Total Fitness, Membership Plans, at [http://www.ballytotalfitness.com/join/membership\\_plans](http://www.ballytotalfitness.com/join/membership_plans) (2003) (listing eight plans, of which four are transferable once). Bally's one-time transferable membership plan gives “the privilege to transfer the membership once . . . . The privilege to transfer the membership is allowed only after the membership fee has been paid in full, provided Member is in good standing and pays a transfer fee of \$100.” *Acevedo v. Bally Total Fitness Corp.*, No. 99 C 1289, 1999 WL 1045035, \*1 n.1 (N.D. Ill. Nov. 12, 1999).

<sup>201</sup> *See* *Steele v. Mt. Hood Meadows Oregon, Ltd.*, 974 P.2d 794, 795 (Ore. App. Ct. 1999) (“Non-Transferable, non-refundable, void if detached.”). Note that although the ski mountain operator does not scrutinize the identity of a ticket bearer when getting on the chairlift, the provision forbidding transfer is enforced by a provision in the lift ticket making it void if removed from the skier's jacket once attached. *See id.*

<sup>202</sup> Restrictions on transfer of ski lift tickets may also be partly justified as a means of enforcing the price discrimination in lift tickets — discounts would not be given to students could students buy a bunch of tickets and sell them to non-student adults who should be paying full price.

### b) Restricting Assignment To Cultivate and Preserve Expertise

A different, but relatively intuitive, reason that parties may restrict assignment to preserve promisor continuity is learning. In many contexts in which the desired performance cannot be fully specified, a promisor can perform better when he knows more about the business of the promisee. Thus while a firm may care about a contractor's credentials as a guarantee or trademark that can be used to predict the quality of performance within some contractually permissible range, it may ultimately value expertise and familiarity with its operations much more. Thus it may expect that the value of the long-tenured contractor's performance within the contractually permissible range will be much more valuable than the performance of anyone without firm-specific expertise.

For this reason, once a promisee contracts with a promisor and trains her in its ways, the promisee will want to retain this increasingly expert promisor.<sup>203</sup> Harm to the promisee would arise were that firm to have the expert promisor replaced by a promisor without the developed expertise.<sup>204</sup>

Note that any departure of a trained promisor — whether through assignment, breach, or termination<sup>205</sup> — will inflict the harm, because in any such situation the promisee will have to turn to a new untrained promisor. Yet restricting assignment of the promisor's performance

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<sup>203</sup> In a related context, Katherine Stone describes Gary Becker's human capital model of employment, and notes that the ability of firms to reap their investment in endowing employees with firm-specific expertise

“Specific” training is . . . training that has value only to the specific firm. “General training” . . . is training that has value to other firms . . . . Once they pay for specific training, employers will encourage employees to stay on the job long enough to make the employer's investment in the training worthwhile. Indeed, the firms' desire to recoup the costs of specific training is frequently cited to explain why employers . . . encourage long-term employment relationships . . . .

Katherine V.W. Stone, *Knowledge at Work: Disputes Over the Ownership of Human Capital in the Changing Workplace*, 34 CONN. L. REV. 721, 751–52 (footnotes omitted) (citing GARY S. BECKER, *HUMAN CAPITAL: A THEORETICAL AND EMPIRICAL ANALYSIS* 19–30 (2d ed. 1975)).

<sup>204</sup> Cf. Seth D. Harris, *Coase's Paradox and the Inefficiency of Permanent Strike Replacements*, 80 WASH U. L.Q. 1185, 1197–98 (2002) (“[E]mployers and their incumbent employees together invest in the employees' acquisition of firm-specific skills and knowledge that make the employees both more productive with their current employer than they would be with another employer and *more productive than other workers the employer might hire.*” (emphasis added)).

<sup>205</sup> Non-breach termination may occur in contracts, like many employment contracts, that are at-will.

obligations reduces the likelihood of harm. Recall that if assignment is permitted the promisor will assign whenever she finds another who values the contract more than she does. The harm could also be inflicted even absent an assignee should the promisor's valuation of the contract fall so low that whatever else the promisor could be expending her resources on is more valuable.<sup>206</sup> Forbidding assignment will make it less likely that the promisor will suffer the harm, then, because it eliminates one of the two ways that the harm can be inflicted — harm will only be imposed when the promisor's valuation of the contract falls low enough.

Therefore, contracts that involve a promisor gaining expertise about the promisee's specific needs should be less likely to permit the promisor to assign. This may be reflected in the assignability restrictions in some patent licenses, where specialized technical expertise in working with an invention may help a licensed manufacturer or distributor to make or sell more effectively and thus produce greater royalties for the patentee;<sup>207</sup> distribution agreements involving products where technical and marketing expertise, or familiarity with customers and clients, developed over time are helpful;<sup>208</sup> the employees' side of employment agreements;<sup>209</sup> long-term technical services contracts<sup>210</sup> and the contracts between companies and their legal, business, and financial advisors who gain intimate knowledge of their clients' operations.

Contracts in which the promisor is an external provider of standardized goods and services, not tailored or unique to the promisee, will not have the same element of unspecifiable performance, and will not result in a particular party's performance being more valuable within

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<sup>206</sup> Note if ceasing performance is a breach, this calculation must also take into account any damages that the promisor would have to pay.

<sup>207</sup> See, e.g., *supra* note 123 (providing examples of royalty-bearing patent licenses that restrict assignment).

<sup>208</sup> See, e.g., *E & J Gallo Winery v. Morand Bros. Beverage Co.*, 247 F. Supp. 2d 973, 975 (N.D. Ill. 2002) (describing an agreement under which a distributor was to distribute wine produced by a winery, which provided that “[n]either Distributor nor the Winery may sell, assign, or transfer its rights under this agreement” (alteration in original); *The Courage Co. v. The Chemshare Corp.*, 93 S.W.3d 323, 327–328 (Tex. App. 2002) (describing an agreement under which a software maker hired distributor to market its software, which agreement “was not assignable without the prior written consent of [the software maker]”).

<sup>209</sup> See sources cited *supra* notes 77–80.

<sup>210</sup> See *ABB Energy Capital, L.L.C.*, 2003 WL 21500530, at \*1 (five-year contract to install and maintain lighting equipment in malls not assignable by the electrical contractor).

the range of permissible performances because of that party's experience. Thus they are less likely to have restrictions on assignment.

### **c) Inducing or Selecting For Cost Internalization**

Another reason that parties may seek to prevent assignment is to take advantage of incentive effects of not being able to transfer one's way out of a relationship. If there is a situation where the desired performance is not completely specifiable, leaving a contractually permissible range, in some contexts it may be that a more valuable performance may be had out of the performing party if that party must internalize more costs and benefits of its own behavior in connection with the contract. That party may, for example, engage in certain kinds of care or investments that will maximize the value of the contract to the parties (a simple example is that the owner of an apartment will take better care of that apartment — because she has to live in it — than a renter at the end of her lease who may let the place wear down a bit because she doesn't have to worry about the long-term consequences of this). Restricting assignment may induce parties to internalize costs and benefits and “act like an owner,” or it may initially or after some time tend to select to remain in the contractual relationship only those who will internalize.

To continue the simple example — one could imagine that internalization incentives give a landlord another reason to restrict assignment of residential leases. If a tenant can assign the lease, then instead of one period where the resident will have less interest in looking after the apartment because she will soon move out, there will be two such periods: the first when the tenant hands the place over to the subtenant, and the second when the subtenant vacates.

Professor Priest describes how non-internalizers are partially selected out in the product warranty context: while many warranties are transferable to a subsequent purchaser,<sup>211</sup> many are not.<sup>212</sup> Priest argues that where “the intensity of the first purchaser's use [and thus wear and tear] cannot be detected by second-hand purchasers, those first purchasers who expect to transfer products to others may invest relatively less in care and maintenance or may subject products to

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<sup>211</sup> See, e.g., Toshiba Notebook Computer Warranty, *available at* [http://cdgenp01.csd.toshiba.com/content/support/pdf\\_files/stdwar/c1695-2\\_nb1yr\\_20030129.pdf](http://cdgenp01.csd.toshiba.com/content/support/pdf_files/stdwar/c1695-2_nb1yr_20030129.pdf) (“Customer may assign the Limited Warranty to a subsequent purchaser or assignee of the Product by providing written notice to Toshiba . . .”);

<sup>212</sup> See, e.g., Emerson, Limited Warranty (DVD Player with Video Cassette Recorder) (on file with author) (“This warranty is extended only to the original retail purchaser.”)

a relatively greater volume or intensity of use prior to resale,” resulting in higher service costs for secondhand items.<sup>213</sup> Thus, purchasers who expect to retain products will “prefer warranties that limit coverage to the original purchaser to remove second-hand items from the warranty pool.”<sup>214</sup> Warranties should therefore tend to be non-transferable when they involve goods for which selling involves a substantial information asymmetry as to how the original owner treated them — such as components of a house that receive wear and tear from the residents,<sup>215</sup> a mattress that may receive more or less use without this being noticeable,<sup>216</sup> or perhaps home electronics with moving parts<sup>217</sup> — while warranties should tend to be transferable when purchaser care will not seriously influence the warranty relationship, or where the wear that one purchaser places on a product is measurable, such as car mileage.<sup>218</sup>

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<sup>213</sup> Priest, *supra* note 4, at 1335–36.

<sup>214</sup> *Id.* at 1336.

<sup>215</sup> See, e.g., *Tri/Sam Development, Inc. v. Fine Artz*, No. B160490, 2003 WL 22333324, \*2 (Cal. Ct. App. 2003) (describing a warranty for stucco work installed by subcontractor Fine Artz, which provided that “[t]his limited warranty extends only to the buyer and is non transferable”); *Ainsworth v. Perreault*, 563 S.E.2d 135, 137 (Ga. Ct. App. 2002) (describing a warranty for a vinyl-liner swimming pool in which the constructors warranted that the pool would remain structurally sound; and which provided that “the warranty would become void ‘if there was a transfer or change of ownership of the real property on which the pool is located.’”).

This classification, however, is far from perfect. See *Hicks v. Superior Court*, 8 Cal. Rptr. 3d 703, 706 (Ct. App. 2004) (describing a warranty by a builder on newly constructed homes, transferable to subsequent purchasers, for one year on workmanship, two years for defects in “major components,” and ten years for structural defects).

<sup>216</sup> See Sealy, *Warranty Info & Registration: Sealy Posturepedic Warranty for purchases after June 2003*, <http://www.sealy.com/customerSupport/warrantySealy.asp> (last visited July 18, 2004) (“In order for this limited warranty to be valid, you must . . . [b]e the original consumer purchaser.”).

<sup>217</sup> See *Emerson, Limited Warranty*, *supra* note 212.

<sup>218</sup> Priest, *supra* note 4, at 1138, argues that where wear on a product correlates with a measurable volume of use — such as milage on a car — making the warranty depend on that measure instead of, say, time, enables companies to exclude heavy users from coverage. Thus there is no need to limit the warranty to the original purchaser. See, e.g., *McGettigan v. Ford Motor Co.*, 265 F.Supp.2d 1291, (S.D. Ala. 2003) (“Plaintiffs’ claims are based on a transferable written manufacturer’s warranty issued by [Ford], which warranted that any existing defects in automobiles would be repaired, free of charge, to the purchaser or any subsequent owner.”);

*Chrysler, Warranty Coverage 1, 5 available at*

<http://www.chrysler.com/crossbrand/warranty/pdf/04cdj100103.pdf> (last visited February 29, 2004)

(showing how various aspects of vehicle warranty expire after various year/mileage levels; and showing

Recall that all of this fits within the larger analysis of the cost to the manufacturer depending upon the conduct of the consumer toward the product — conduct which is specifiable only at great cost and which is therefore only specified in broad sketches such as by excluding coverage for abuse or after commercial use of a home product.<sup>219</sup> The costs of the manufacturer's obligations to those who exercise their contractual discretion to act unlike permanent owners and fail to internalize the costs of their use of the product will be greater (because they will cause more wear and tear) than the costs of the obligations to those who do act like permanent owners and internalize costs of their product use.<sup>220</sup> Thus, for products where there are information asymmetries about a first owner's care, the limitation on transferability will cut out a substantial part of the costs of remaining in a contractual relationship (by ending the relationship upon transfer) with those who are likely to sell and thus unlikely to internalize, while preserving the lower-cost obligations to the internalizers. So, the restriction on assignment seeks to confine the manufacturer's obligations to those with the right incentives to take care of the product and impose fewest warranty repair costs — it is also possible that the restriction will induce consumers to have these incentives: because they cannot sell the product with the warranty, they may be less willing than they otherwise would be to sell it, and as a result tend to take better care of the product they will keep themselves rather than sell used.

The fact that forbidding assignment may induce or select for incentives to behave like a permanent owner may in part motivate the restrictions on assignment in some business relationships. A franchisor and franchisee, for example, may seek to ensure that the franchisee puts in his best efforts to running the business, and to achieve that may tie the franchisee to the business by making it more difficult to escape from the relationship. Priest's analysis applies: a lazy franchisee may be able to harm future revenues by dissipating customer goodwill, but this

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how any purchaser of the vehicle is covered by the Basic Limited warranty; how the Powertrain Warranty is limited to original purchaser unless transfer fee is paid; Priest, *supra* note 4, at 1338 (describing this feature of automobile warranties).

<sup>219</sup> See, e.g., Emerson, Limited Warranty, *supra* note 212 (excluding coverage for “damage which results from accident, misuse, abuse, mishandling, misapplication, alteration, faulty installation, improper maintenance, [or] commercial use”).

<sup>220</sup> Note this analysis makes the quite reasonable assumption that the warranty doesn't shift all of the costs of wear and tear from the user to the manufacturer. Cf. Priest, *supra* note 4, at 1298 (Noting that a warranty is “a contract allocating responsibility between a manufacturer and a consumer for investments to prolong the useful life of a product”).

devaluation may be hard to detect by the franchisor or subsequent franchisee purchasers — the franchisee will not bear all the costs of his own laziness and thus will lack the best incentives to work. If the franchisee’s option of extracting value from the contract by selling it is limited, the franchisee will instead be induced to maximize the value of the contract to him by working to make the business succeed. These considerations may thus manifest themselves in the restrictions on assignment seen in most franchise agreements;<sup>221</sup> they may also manifest themselves in what may be an anti-speculation provision in some franchise agreements that absolutely prohibits any transfers of the franchise agreement within a certain time period after first acquiring it.<sup>222</sup>

Therefore, the fact that a party who cannot as easily extricate herself from a contract is more likely to bear the costs and benefits of her conduct (especially in situations where any potential assignee cannot accurately tell what he is buying) and therefore to engage in conduct less costly for her contracting partner means that restrictions on assignment can be used to either induce the party to engage in that less-costly conduct, or at least select for parties who were likely to adequately internalize the costs of their conduct anyway.

#### **d) Contrast: Assignments Permitted If No Relevant Conduct**

As with the more traditional category of contracts involving unspecifiable performance where a party’s characteristics or identity serve as the guarantee of performance, concerns about assignment in the realm of unspecifiable performance where the desired performance is guaranteed by the fact of the party’s continuity are mitigated when the value (or cost) of the contract to the other party does not depend significantly on the first party’s conduct.

For example, many warranties exclude coverage for losses that depend significantly on the conduct or care of the consumer and seek to focus on losses arising from faults of products as made.<sup>223</sup> This is because warranties allocate responsibility for investments in product life

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<sup>221</sup> See *supra* TAN 99–110.

<sup>222</sup> See, e.g., Interview with Anonymous Franchisee (Oct. 31, 2003) (describing a provision in a franchise agreement that prohibits the franchisee from transferring its franchise within the first six months of acquisition).

<sup>223</sup> One Toshiba warranty excludes: damage caused by “accident, misuse, abuse, neglect, improper installation, or improper maintenance,” clearly consumer-conduct-oriented; “[r]eplacement or fixes of software,” as software is beyond manufacturer control; and “[r]epair or replacement of batteries, covers, plastics, or appearance parts such as interior or exterior finishes or trim,” which are probably most

between manufacturer and customer according to who is better at making which kinds of investments,<sup>224</sup> and losses that can be affected by product-care consumer conduct are likely to be more efficiently avoided by the consumer. So whereas the expected cost of performance by an automobile insurer correlates heavily with the behavior (predicted by the insurer) of a particular insured party, the expected cost of a warranty varies less by promisee and depends principally on product quality.

Therefore, an assignment of the warranty (and product) should in some cases — where the warranty contract can effectively shift most costs related to consumer use of the product over to the consumer — not inflict substantial harm upon the manufacturer-promisor.

This — in addition to the possibility that an original purchaser's care incentives are good when care taken is observable by subsequent purchasers — provides another reason why some warranties are transferable with the product.<sup>225</sup> Although the allocation of costs between manufacturer and consumer should not in all cases perfectly track the line between manufacturer and consumer conduct. We therefore should expect to see a mix of transferable and non-transferable warranties, which we do.<sup>226</sup>

### **3. Reputation — Identity Used as Proxy for Third-Party Conduct**

The previous two sections have discussed two separate but combinable reasons why parties restrict assignment to guarantee that expect performance is delivered even though it is too costly to specify by contract: when what one party knows about the other leads the first to conclude that the performance will be right; and when the very fact that the other party remains the same helps assure that the performance will be right. Restrictions on assignment may also be mutually beneficial when one party relies on the reputation of the other in order to get a desired response out of third parties. This is similar to but distinct from using reputation in the

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susceptible to customer abuse. Toshiba America Information Systems, Inc., SelectServ® Service Plan Agreement ¶ F (2002) [hereinafter Toshiba Computer Warranty], *available at* [http://cdgenp01.csd.toshiba.com/content/brochures/selectserv\\_agreement\\_20020711.pdf](http://cdgenp01.csd.toshiba.com/content/brochures/selectserv_agreement_20020711.pdf).

<sup>224</sup> Priest, *supra* note 4, at 1313.

<sup>225</sup> Shear v. Fleck, No. 79059, 2001 WL 1110337, \*1–2 (Ohio App. Ct. Sept. 13, 2001), which describes warranty coverage for basement-waterproofing services that were transferable to any subsequent owner of the house, may provide an example: it is unlikely that anything that the consumer would do could have much effect on how costly this warranty for the repairers to honor.

<sup>226</sup> See *supra* TAN 211–217.

trademark capacity described above — where a promisee relies upon the reputation of a promisor to conclude that the promisor will perform well or do “good work” itself.<sup>227</sup>

For example, a corporation may hire a litigation firm with a reputation for fierceness in the hope of inducing opponents to offer favorable settlements, or hire McKinsey for consulting to garner investors’ approval for a new project. It may be that another law firm conduct itself and create the same quality work product as the fierce-reputation firm; and that other consultants will provide the same analysis. But if these other firms lack the reputation, then the litigation opponents and corporate investors may not respond as desired: the opponents may not fear the lawyers and thus be more willing to risk trial, and investors may not view the company’s strategy as sound if not certified by McKinsey.

The fact that it is third-party responses that compose the desired “performance” means that it is not contracted for directly from them, and because that response is not under the direct control of the promisor the promisor will be unable (or unwilling) to promise particular third-party conduct. Thus the expected performance is something becomes an unspecified obligation — and there is a range of contractually permissible third party responses that can occur, some more valuable than others.

So the promisee hires the promisor not for its own performance, but because it trusts that its reputation will result in particularly valuable third-party responses within this range. An assignment of the contractual relationship to an assignee who lacks the promisor’s reputation may harm the non-assigning promisee because the assignee may not induce the valuable third-party effects. Therefore the parties will be unlikely to permit assignment to avoid this harm.

In addition to service providers like law firms and consulting firms, whose service contracts will be “personal” and thus non-assignable by default, contracts that we may expect to see not assignable because of a promisor’s reputational effect on third parties might include retail space landlords who lease space to retailers with famous brand names in order to bring customer

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<sup>227</sup> Related in the sense that the concept of the promisor’s “performance” can be cast broad enough to include inducing third parties to act in certain ways. A retail business’s successful distribution of a product, for example, may depend upon its reputation and ability to generate customer traffic and therefore revenue to its suppliers.

traffic to maximize percentage rent revenues or to bring revenues to other stores in a shopping center.<sup>228</sup>

Another example may be country-club memberships, many of which are non-transferable.<sup>229</sup> A club's ability to attract new members depends in part on the social stature and reputation of existing members, who some clubs are or historically were careful in selecting.<sup>230</sup> This selectivity and the valuable but unspicifiable (as far as existing membership contracts are concerned) responses other high-class folks in being attracted to the club and being willing to pay high membership fees would be undermined should assignments to undesirable assignees be made.

### **B. Varying Remedy Costs: Nonperformance Even If Obligations Specified**

Section III.A discussed the various ways in which the non-assigning party can be harmed when the other party's desired performance cannot be specified because it is too costly to do so, and that this often makes it mutually beneficial for the parties to restrict assignment of the contract.

Limits of assignment may also be optimal even when desired performance is completely specified when remedies and enforcement are cheaper or more effective against some individuals than against others. A canonical example is a credit agreement: the terms of a loan may require

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<sup>228</sup> Cf. Meislik, *supra* note 146, at 85 (“Brand names have images. Typically, they are national advertisers that draw customers to the shopping center. Customers have confidence in brand name retailers and will travel quite some distance to shop at their stores. Therefore, it is a legitimate landlord concern that the tenant whose name is on the lease replaces itself only with a retailer of comparable status.”).

<sup>229</sup> See, e.g., *In re Palmer*, 167 B.R. 579, 585 (Bankr. D. Ariz. 1994) (noting that the debtor's “membership in an Arizona Country Club . . . is nontransferable”); *McClerin v. McClerin*, 425 S.E.2d 476, 479 (describing a non-transferable country club membership with a \$12,000 initiation fee).

<sup>230</sup> See, e.g., Jennet Conant, *Tuxedo Park Opens the Gates, Just a Bit*, N.Y. TIMES, Aug. 16, 2002, at F1 (“Admission [to the Tuxedo Club] requires the same sponsors, letters of recommendation and initiation fees that most country clubs do . . . .”); Associated Press, *Yacht Club Yields on Members*, N.Y. TIMES, Mar. 13, 2002, at A22 (“The Royal Palm Yacht and Country Club . . . [previously] required that candidates be sponsored by two members and receive letters of recommendation from three others.”); Paul Harber, *Devine Intervention Franklin Five To Visit TCC*, BOSTON GLOBE, May 18, 2000, at C11 (“The Franklin Park golfers play The Country Club, one of Greater Boston's most exclusive private clubs, where you need a dozen letters of recommendation simply to be considered for membership.”); see also James K. Gooch, *Fenced In: Why Sheff v. O'Neill Can't Save Connecticut's Inner City Students*, 22 QUINNIPIAC L. REV. 395, 445 (“membership is reserved for others who look the same as those in the club already”).

the borrower to pay a bank \$1000 each month for ten years. Although the desired performance is fully specified, such a loan agreement is far more valuable to the bank if the borrower is a wealthy individual than if it is a small business on the brink of bankruptcy.

The difference between different promisors making the same completely specified promise is the cost and effectiveness of remedies to make those promisors perform. A mere letter that a payment is thirty days past due and that another delay will stain a credit report is likely to induce a creditworthy borrower to produce the \$1000. The most expensive lawsuit will not squeeze \$1000 from an indigent borrower. Facing the prospects of varying cost and effectiveness of remedies, a promisee is likely to spend resources investigating a potential promisor's characteristics — such as history of timely payment and financial profile — to determine whether inducing performance will be a low-cost or a high-cost affair. The potential promisee will then price accordingly (or not enter the contract at all). The value of the agreement to the promisee is clearly greater if the promisor is a low-remedy-cost type rather than a high-remedy-cost type, and the sudden replacement of a low-remedy-cost promisor with a high-remedy cost one will reduce the value and harm the promisee.

This simple story seems enough to explain the fact that many agreements where one party extends credit to a second or where the second takes on payment obligations over time — mortgages,<sup>231</sup> automobile financing<sup>232</sup> and other credit agreements,<sup>233</sup> automobile leases,<sup>234</sup> real

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<sup>231</sup> Since federal law in 1982 preempted state law's prohibition on clauses in mortgages making the entire balance due upon the mortgagor's sale of the property, most mortgages have included due-at-sale clauses. See R. WILSON FREYERMUTH ET AL., ANATOMY OF A MORTGAGE 117 (2001). The Fannie Mae/Freddie Mac form for fixed rate home mortgage notes reads:

If all or any part of the Property or any interest in it is sold or transferred (or if a beneficial interest in Borrower is sold or transferred and Borrower is not a natural person) without Lender's prior written consent, Lender may, at its option, require immediate payment in full of all sums secured by this Security Instrument.

Fannie Mae, *Multistate Fixed Rate Note — Single Family* ¶ 10, reprinted in GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE TRANSFER, FINANCE & DEVELOPMENT 1201, 1204 (6th ed. 2003). This effectively prevents the mortgagor from assigning her repayment obligations under the mortgage without the approval of the mortgagor. See FREYERMUTH ET AL., *supra*, at 117.

<sup>232</sup> See E-mail from GMAC Financing to Jared Kramer, Jan. 2004 (on file with author) (indicating that a financed GM automobile and its associated financing agreement cannot be transferred).

<sup>233</sup> Checking overdraft protection enables a depositor to write checks for more money than is in her account: the bank will advance the difference, later collecting repayment plus financing and other fees.

estate leases<sup>235</sup> — are not assignable: the creditor or lessor has fixed a price based the expected cost of getting performance out of the promisor, and an assignment to a higher-remedy-cost promisor directly reduces the value of the promise to the promisee.<sup>236</sup>

But unlike the case in which an assignment to an inferior performer who fails to deliver some unspecifiable performance — in which there is no remedy because the delivered performance complies with the contract — here there remains a remedy because the required performance is fully specified and because (by default rule) assigning promisors remain liable for the promised performance.<sup>237</sup> So why shouldn't a creditor be satisfied even with an assignment if the original, presumably low-remedy cost, debtor remains on the hook?<sup>238</sup>

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*See, e.g.*, First Citizens Bank, Overdraft Protection, [http://www.firstcitizens.com/personal\\_services/checking/overdraft\\_protection/](http://www.firstcitizens.com/personal_services/checking/overdraft_protection/) (last visited March 19, 2004). Such agreements are not assignable by the customer. *See, e.g.*, Netbank, *supra* note 191 (“You may not assign your rights or obligations under this Agreement or your [checking overdraft protection plan].”).

<sup>234</sup> *See, e.g.*, Toyota Financial Services, Closed End Motor Vehicle Lease Agreement ¶ 22 (Nov. 2003) (on file with author) (“Assignment or subleasing by you of the Vehicle or Lease is strictly prohibited.”).

<sup>235</sup> *See supra* section III.A.1.e).

<sup>236</sup> *Cf.* R. WILSON FREYERMUTH, ET AL., ANATOMY OF A MORTGAGE 116–17 (2001) (“When a lender makes a loan to a specific borrower that is secured by a mortgage . . . the lender does so after evaluating the borrower’s creditworthiness, reputation, and experience . . . . Consequently, it is important to the lender that . . . the borrowing entity—and ultimately, the people who control the borrowing entity . . . does not change without the lender’s consent. . . . One way for the lender to obtain such assurance is to prohibit any transfers of the mortgaged property . . .”).

<sup>237</sup> *See* *Holland v. Fahnestock & Co.*, 210 F.R.D. 487, 498 (S.D.N.Y. 2002) (“The act of delegation . . . does not relieve the delegant of the ultimate responsibility to see that the obligation is performed. If the delegate fails to perform, the delegant remains liable.” (quoting *Contemporary Mission, Inc. v. Famous Music Corp.*, 557 F.2d 918, 924 (2d Cir.1977) (internal quotation marks omitted) (omission in original)); *Epland v. Meade Ins. Agency Assocs.*, 564 N.W.2d 203, 207 (Minn. 1997). *See also* U.C.C. § 2-210(1); FARNSWORTH, *supra* note 6, § 11.10, at 742–43.

<sup>238</sup> Dimatteo, *supra* note 6, suggests that the assignor’s guarantee implies that assignment will not be very harmful to the non-assigning party. *Id.* at 435–36 (“If, for example, the assignor expressly agrees to remain liable for the performance of the assignee then the pendulum should swing in favor of assignability.”).

The problem is that in many cases, the assignment itself turns the relatively low-remedy-cost initial promisor into a higher-cost guarantor. A lawsuit is a very costly method of collecting payment,<sup>239</sup> and the law’s preservation of that remedy may not be very helpful to a creditor.

Many of the lower-cost remedies that make having a particular promisor valuable derive not only from the promisor’s characteristics but depend on the contractual relationship and the rights the promisor has — for example, the promisee could threaten to deny rights conditioned on certain performance. Thus, a relatively low-cost remedy to collect rent under a commercial lease is to threaten to lock up the premises and disrupt the tenant’s business,<sup>240</sup> or in the case of an automobile lease to take the car.<sup>241</sup> If an assignment of the performance obligation occurs, however, an assignment of the rights is likely to occur as well.<sup>242</sup> Then any low-cost remedies that arose from the contractual relationship and ability to withhold future rights are lost. For example, if a tenant assigns her lease, even though the original tenant may remain obligated to pay the rent, the landlord has much less leverage because he doesn’t have as much to threaten (the landlord can’t threaten to kick you out if you’re already out). The low-cost remedies may be replaced in some degree by corresponding remedies against the assignee (the landlord could

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<sup>239</sup> Professor Whitford noted that in the payment collection system, voluntary or bargained repayment was the dominant method of recovery, compared to coercive execution, *see* William C. Whitford, *A Critique of the Consumer Credit Collection System*, 1979 WIS. L. REV. 1047, 1051. He explains that the high costs of formal collection methods are responsible for this — both the level of actual expenses, *see id.* at 1053 (“Although [obtaining a judgment to collect unsecured debt] is not difficult . . . it remains an expense.”), and the possibility that the obligation is declared invalid, *see id.* at 1055.

For a general discussion of creditors’ leverage over debtors, *see* ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS & CREDITORS* 3–8 (4th ed. 2001).

<sup>240</sup> *Cf.* MARTIN MAYER, *THE BANKERS* 263–64 (1974) (quoting a Bank of America lending guide that reads: “*Leverage.* As long as the applicant remains in business, the equipment and machinery necessary to his business operation are important. . . . Therefore, the fact that it is secured gives greater incentive . . . to meet his payments”); Ithaca Apartment Lease, *supra* note 134, ¶ 11 (“[I]f said tenant shall fail to pay the rent . . . this agreement shall, at the option of the landlord cease and terminate after three days’ written notice . . .”).

<sup>241</sup> A car lease, Toyota Financial Services, *supra* note 234, ¶ 29, reads: “You will be in default if . . . you fail to make any payment when it is due . . . . If you are in default we may do any of the following after giving any legally required notices, and after expiration of any legally required cure or reinstatement periods: i. terminate this Lease and your right to use the Vehicle; ii. take possession of the Vehicle from your property or elsewhere . . . .”

<sup>242</sup> This may be a formal requirement, or may simply reflect the reality that an assignee would only be willing to accept performance obligations if she also received the benefits of the contract.

threaten to lock up the assignee's premises to get the assignee to pay), but the remedies may not be as effective or cheap against the assignee's characteristics. The assignee may be in financial distress, meaning that some low-cost remedies such as threats may not induce payments, requiring the promisee to resort to more expensive legal enforcement mechanisms.

Thus, though the explanation of why the non-assigning party can be harmed even when performance obligations are completely specified and when an assignor remains liable for his promises even after assignment, the potential for varying costs and effectiveness of remedies to enforce those obligations can lead to restrictions on assignment being mutually beneficial by preventing this harm.

### **C. Bearing the Other Party's Non-Conduct-Oriented Risk**

A third context where assignment can either decrease value of performance to a non-assigning promisee or increase a non-assigning promisor's cost of performance — and therefore where restrictions on contract assignment are likely to be mutually beneficial to the parties — is where one party bears another's risk and where the level of risk varies from person to person. Already discussed are insurance contracts where an insurer bears risk associated with an insured's conduct (such as driving in auto insurance or business activities in commercial liability insurance) where the insured's conduct is not specified by the contract.<sup>243</sup> However, harm can also come to a non-assigning party when that party learns about and bears the other party's risks where those risks are not related to that party's conduct.

Naturally, if one party bears the risk of another with low conduct-independent probability of being struck by a calamity, the first party has a low expected cost; an assignment of the second party's interest in the contract to a high-conduct-independent risk person will increase the non-assigning party's risk-bearing costs. So if the non-conduct-oriented risk borne by a promisor varies significantly depending on who is the promisee, then it is likely that the parties will find it mutually beneficial to restrict assignment.

Some kinds of insurance provide a good example of this. Risks that insurers bear have two origins (and can lie on a spectrum between them): those dependent on conduct and those independent of conduct. Where auto insurance risks are conduct-oriented, life and health insurance policies cover a substantial amount of non-conduct risk. An insurer will assess risk

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<sup>243</sup> See *supra* section III.A.1.g).

and fix premiums based on factors such as age, sex, and prior medical conditions. When the insurer computes the probability of death, injury, or illness, the insurer is probably not drawing conclusions about how the insured will behave:<sup>244</sup> rather, the insurer associates persons with these characteristics with a certain level of risk based on matters of biology that have nothing to do with their conduct.

Given this interest, one would expect these kinds of insurance policies to be non-assignable. Indeed, health insurance policies generally have limited assignability.<sup>245</sup> Life insurance policies are somewhat different because the party contracting with the insurer is the “owner” and not necessarily the insured and this interest can often be transferred,<sup>246</sup> but the person whose risk is being borne — the insured — does not change.

#### **IV. Considerations Other than Cost or Value of Performance**

Part III discussed the reasons why it is mutually beneficial to the parties to restrict assignment when assignment will harm the non-assigning party (and where, on average, the assigning party will not gain as much as this loss) by raising the cost of his performance if he is a promisor, or by lowering the value of the performance he receives if he is a promisee. This Part discusses why it may maximize the joint value to the parties of contracts to restrict assignment even when assignment does not affect the cost or value of the actual performance delivered. There are at least two such reasons to restrict contract assignability: to enable one party to engage in profit-maximizing price discrimination, and to eliminate the administrative costs of the assignment itself.

##### **A. Price Discrimination**

One reason that parties restrict assignment to increase the joint value of their contractual relationship is to enable one party to engage in price discrimination. Price discrimination involves selling a product to different buyers at prices that do not solely reflect the seller’s

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<sup>244</sup> There are some behavioral components: someone who is a smoker is expected to continue smoking and thus subject himself to increased health risk. But note that even this is not purely conduct-oriented. A smoker probably has, regardless of whether she continues smoking, increased health risks because of already-accumulated lung damage.

<sup>245</sup> STEMPEL, *supra* note 167, § 4.6, 147–48 (“Health insurance . . . is generally subject to restricted assignability, because the risks insured are so peculiar to the policyholder’s own health and likelihood of generating claims.”).

<sup>246</sup> *See supra* section III.A.1.j)

difference in cost between serving those customers but instead track buyers' different willingness to pay.<sup>247</sup> The simplest variant is selling the same product at different prices.

Where the “product” is a contractual relationship, prohibiting assignment enables price discrimination. “[F]or price discrimination to be possible, resale (i.e., transfers of commodities between submarkets) must be impossible or must be prevented;”<sup>248</sup> if buyers can resell the goods they buy, the seller will be unable to sell a product at a higher price to high-demand buyers if low-demand buyers can buy at their low price and resell.<sup>249</sup> While it may be difficult to prevent the resale of tangible goods, resale of *contractual* products can be prohibited by restricting assignment.<sup>250</sup> For example, movie studios can more easily charge different prices to different movie theaters (based on how much revenue they bring in) if they lease movie reels to the theaters rather than sell the reels: low-revenue theaters who bought their reels cheaply could make money by reselling them to high-revenue theaters and thus prevent studios from charging high prices to the latter; but they can't transfer leased reels if the leases restrict transfer.<sup>251</sup>

### 1. Examples

We do in fact observe many restrictions on assignment in contracts where those contracts are sold in a price discriminatory manner. For example, airline tickets are non-assignable contracts between a passenger and an airline, and it is likely that price discrimination occurs in this market — airlines will charge the more-willing-to-pay business traveler than they will charge non-business travelers<sup>252</sup> — and most airline tickets are not transferable.

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<sup>247</sup> Louis Philips defines price discrimination as “implying that two varieties of a commodity are sold (by the same seller) to two buyers at different *net* prices, the net price being the price (paid by the buyer) corrected for the cost associated with the product differentiation.” LOUIS PHILIPS, *THE ECONOMICS OF PRICE DISCRIMINATION* 6 (1983).

<sup>248</sup> *Id.* at 16.

<sup>249</sup> See KAPLOW & AREEDA, *supra* note 102, ¶ 285, at 436.

<sup>250</sup> See Larry E. Ribstein & Bruce H. Kobayahsi, *State Regulation of Electronic Commerce*, 51 EMORY L.J. 1, 17 (2002).

<sup>251</sup> See Michael J. Meurer, *Copyright Law & Price Discrimination*, 23 *Cardozo L. Rev.* 55, 112

<sup>252</sup> See *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1450 (7th Cir. 1996) (Easterbrook, J.) (“An air carrier sells tickets for less to vacationers than to business travelers, using advance purchase and Saturday-night-stay requirements to distinguish the categories.”). *But cf.* PHILIPS, *supra* note 247, at 9–10 (noting that at least some price differences in airline tickets, such as the lower price of advance-purchase tickets than last-minute tickets, may reflect differing costs to the airline).

Similarly, certain technology or information products are sold to different classes of users, like commercial users and personal users, at different prices. These products often come with licenses that forbid assignment of the license (and therefore of the product), at least by lower-priced users.<sup>253</sup> For a contrast, note that some licenses for full-retail-price software are assignable:<sup>254</sup> even if there is price discrimination going on in these markets, the full-price versions are at the high end of the price spectrum. Thus assignability will not harm the seller by undermining any price discrimination, and yet will have some value to the buyer in preserving

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<sup>253</sup> The “eFax” service assigns a user a fax number and converts all faxes sent to that number into an electronic document and emails the user. eFax offers two tiers of service: In the first, the user is assigned a fax number of a non-local area code, and is limited to a small number of pages per month. This is free to the user (except that the user must receive email solicitations from eFax). The paid tier of service, apparently meant for those who have real business need for a fax number, grants the user a local area code. *See* eFax, eFax Customer Agreement, at <http://www2.efax.com/efax/twa/page/customerAgreement> (last visited March 20, 2004). Note that assignment would undermine this price-discriminatory scheme: a free-service Southern user who gets a (603) fax number would be able to assign its relationship with eFax to a New Hampshire business that would value the local (603) area code, and the New Hampshire business would get around the eFax price restriction (although there is still the page limit). To avoid this, a user’s eFax service is not assignable. *See id.* ¶ 21 (“You may not assign or transfer this Agreement or any rights hereunder, and any attempt to the contrary is void.”).

<sup>254</sup> The End-User License Agreement for Adobe Acrobat 6.0 Reads:

No Transfer. You may not lease, sell, sublicense, assign, or transfer your rights in this Software . . . . You may, however, transfer all your rights to Use the Software to another person or legal entity provided that: (a) you also transfer (i) this agreement; and (ii) the serial number(s), Software, and all other software or hardware bundled, packaged, or pre-installed with the Software . . . ; (b) you retain no copies, including backups and copies stored on a computer; and (c) the receiving party agrees to the terms and conditions of this Agreement . . . .

Adobe, Software License Agreement for Adobe Acrobat 6.0 ¶ 4.4, *available at* [http://www.adobe.com/products/eulas/pdfs/acro6.0\\_combined041403.pdf](http://www.adobe.com/products/eulas/pdfs/acro6.0_combined041403.pdf) (last visited March 20, 2004).

Microsoft permits a one-time assignment of its retail software licenses to other similarly situated end users:

Transfer to Third Party. If you are the person who initially licensed the Software, you may make a one-time permanent transfer of this [End User License Agreement], Software, and Certificate of Authenticity (if applicable) to another end user, provided that you do not retain any copies of the Software.

Microsoft Corp., End User License Agreement for Microsoft Software ¶ 14, *available at* <http://www.microsoft.com/office/eula> (last visited March 20, 2004) (license agreement for Office Standard Edition 2003, Word 2003, Excel 2003, Outlook 2003, Visio Standard 2003, and others).

her ability to sell the software later when she doesn't need it. In keeping with this distinction, low-priced versions of retail software such as educational or trial versions are often non-assignable. Assignment of those software licenses would undermine the price discrimination if normal customers who otherwise would buy the software for full price from the vendor could acquire it cheaper on resale from educational institutions, which got a discount.<sup>255</sup>

Another example, alluded to above, is in the movie industry. One commentator notes that “[m]ovie producers have long relied on leases to implement price discrimination. Higher rental rates are set for more profitable exhibition locations and often lease rates are simply a fraction of ticket revenue.”<sup>256</sup> Since leases can be made non-transferable, an “exhibitor who arbitrages by resale [of a movie reel] will violate the lease.”<sup>257</sup>

Equipment leases are another instance in which items are leased to different classes of customer rather than sold, and where this enables pricing distinctions to be made between those classes. For example, businesses and nonprofit institutions might be charged different rates (through such mechanisms as “educational pricing”) to lease equipment like photocopiers or computing equipment.<sup>258</sup> And those leases may be made non-assignable to prevent the low-rent lessees from assigning their leases to high-rent lessees.<sup>259</sup>

Restriction on assignment of contracts between members of different price classes can also occur more informally, as in movie tickets. Children and seniors can purchase discounted tickets. While movie theaters don't care if I sell the \$10 ticket I buy to a coworker or if my 8-year-old niece sells her \$5 to her best friend, they do care if a person who (properly) paid the senior citizen price sold his ticket to a young professional, as this would undermine their price discrimination scheme whereby I pay more than my grandparents and my nieces and nephews. This is “more informal” merely because the restriction on assignment between the different price classes is effected not by formal transfer restrictions on tickets, but visually by the ticket

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<sup>255</sup> See, e.g., Adobe, *supra* note 254, ¶ 4.4 (“Notwithstanding the foregoing, you may not transfer education, pre-release, or not for resale copies of the Software.”).

<sup>256</sup> Meurer, *supra* note 251, at 112 n.238.

<sup>257</sup> *Id.* at 112 n.239.

<sup>258</sup> See, e.g., GHA Associates, Our Services, <http://www.gha-associates.com/services.htm> (last visited August 14, 2004) (noting that GHA offers “New Equipment Sales and Leases” and “Special Government & Educational Pricing”).

<sup>259</sup> See, e.g., Pitney Bowes Lease (on file with author).

collector who makes sure that the ticket I present didn't get transferred to me from a low-price buyer.

A final note worth mentioning is on an alternative to assignment restriction that is fruitfully used to enable a party to price discriminate. Where a buyer's willingness to pay for a contract product is different from another buyer's because the buyers use the products differently, rather than simply liking the product more, or getting more value from the product indirectly (as in the case of business travelers who "use" their airplane seats in the same way as others but who make more money from that use), use restrictions can provide an effective and possibly superior method of restricting assignment between members of different price classes.<sup>260</sup> Moreover, use restrictions preserve the ability to transfer within classes, which may be valuable to someone who expects that she may not value the product as much after some time.

## 2. Analysis of Mutual Benefit

In the above examples, assignment restriction enables a seller to engage in price discrimination and thus earn more profit than it could if resale arbitrage could happen and the seller could only charge a single price to all customers. Yet for such a contract term to appear, we must explain why, given that price discrimination permits the seller to capture much of the (potential) consumer surplus,<sup>261</sup> restricting assignment to enable price discrimination is mutually beneficial, maximizing the joint value of a contract to buyer and seller?

The economic argument is iterative. Imagine  $n$  submarkets into which the seller can divide the market, with group 1 the buyers who least value the product (low-demand) and group  $n$  the buyers who most value the product. For example, group 1 could be individual private users and group 2 could be corporations. Members of group 1 face a choice between purchasing a contract that they cannot assign, and purchasing an assignable contract. Note the non-assignable contract will be offered at a discount: charging a low price to group 1 will not prevent the seller from charging more to higher-valuing customers (and the seller can profit so long as

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<sup>260</sup> The *ProCD* case is an example. The maker of a CD-ROM telephone directory sold the directory to the general public for personal use at a lower price than to those in "the trade." *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1449 (7th Cir. 1996). The license, while not containing a restriction on assignment, limited the "use of the application program and listings to non-commercial purposes." *Id.* at 1450. This effectively prohibited assignment between personal and commercial users, but permitted assignment within each class.

<sup>261</sup> See PHILIPS, *supra* note 247, at 12–13.

the group 1 price exceeds marginal cost). If assignment were allowed, the group 1 price would be higher because it could no longer charge more to group 2 than it would to group 1 (or at least the price differential would be smaller because of the competition from arbitrage).

It is likely that group 1, or at least a majority of it,<sup>262</sup> will choose the discount and restriction. First, the discount may enable some lower-demand buyers who would otherwise be priced out of the market to transact at a price they like. Second, those who would buy anyway probably value the discount more than they would the ability to resell their contract. Should assignable contracts result in a single-price market, ability to resell is worthless. Should some price variance remain, the buyer must consider whether it is better to get the discount from buying, or to preserve the opportunity to resell at a higher price. For most buyers, it will probably be better to get the buying discount — they are in the buyer market (e.g., consumers of software) rather than the seller market (sellers of software) because they are not as effective at selling as the seller is.<sup>263</sup> They are therefore likely to earn less buying contracts from the seller and reselling them to higher-valuing groups than the seller will earn by selling to the higher-valuing groups directly.<sup>264</sup> As a result, the joint value of the contract between a typical member of group 1 and the seller is to deny resale rights to buyers (compensating them with a discount) and allocate the job of selling to higher-valuing customers to the seller. So, group 1 will prefer nonassignability and a discount. Note that this facilitates the charging of higher prices to other groups, but that is not the concern of group 1.

Given group 1's segregation, there is the residual market of buyers in groups 2 through *n*. Group 2 now faces the same choice — assignable contract or nonassignable contract plus discount. Group 2's decision in this residual market is the same as group 1's decision in the full market, and group 2 will probably prefer non-assignability, and joint value between group 2 and the seller will be maximized by allocating to the seller the ability to sell its contracts to higher-value users. This logic prevails for all groups: the members of each group will prefer to accept a

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<sup>262</sup> I assume that given the seller's ability to partition the market into certain groups, the contracts offered to those groups are standardized for cost-saving reasons, and that therefore the choice made by any group is that preferred by the preferences predominant in that group. See Priest, *supra* note 4, at 1307–08 & nn. 74, 76.

<sup>263</sup> They may be less efficient, or they may lack the goodwill and brand recognition of a known seller.

<sup>264</sup> One could imagine the opposite might be true if, for some reason, the seller lacked access or recognition in much of the buyers' market, while the buyers knew each other well.

nonassignable contract and get the lowest price the seller will offer, rather than retain what is probably a not very valuable opportunity to sell to customers who value the contract more than they do.<sup>265</sup>

### **B. Administrative Cost of Assignment**

A final reason that parties may wish to limit assignability is that assignment may simply be a headache —administratively costly for the non-assigning party. One could imagine this to be particularly true with mass-marketed contracts. If one party contracts with thousands of counterparties, there may be significant overhead involved in setting up a mechanism for transferring one counterparty’s contractual rights and obligations to an assignee. The non-assigning party may need to build a more sophisticated database; it may need to hire additional customer service representatives to handle transfer requests as well as sales; and it may need to adopt an enforcement mechanism to separate fraudulent from real contractual claims of those who claim to be assignees.<sup>266</sup> Thus, the harm to the non-assigning party comes not from differences in value of the assignor’s performance and the assignee’s performance, nor from it being more costly to serve the assignee than the assignor. The harm is imposed by the assignment transaction itself.

One possible method for the parties to deal with this is to impose a transfer fee to cover the average administrative cost of assignment to the non-assigning party. This could be a value-maximizing contract provision for the parties: if it costs one party \$25 in administrative expenses to process an assignment, then making the other party pay \$25 will ensure that only assignments that are jointly welfare maximizing will be made. The assigning party will only be willing to pay the fee to accomplish an assignment that is worth at least \$25 to him. Thus the only assignments that are made are those where the value to the assigning party exceeds the cost to the non-

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<sup>265</sup> Note the collective action problem: could all buyers act together, they would probably prefer a single price for everyone and keep the total consumer surplus (which could be distributed among them). But acting separately, it is rational for each group’s members to pursue their own interests by getting the discount.

<sup>266</sup> Some cost needs to be expended to verify the truth of the statement: “I have an account with you that I bought from one of your former customers.”

assigning party. Examples of contracts that use transfer fees are some sports season tickets,<sup>267</sup> some automobile warranties,<sup>268</sup> and some health club memberships.<sup>269</sup>

However, other contractual relationships that seem susceptible to administrative costs in assignment simply prohibit assignment altogether, perhaps because these non-assigning party costs are simply too high relative to the value to the expected benefits to the assigning party of effecting an assignment. For example, AAA memberships are not transferable,<sup>270</sup> which in part may reflect the fact that it is relatively inexpensive to verify membership (and thus perform services) when a member possesses a card issued by the association that cannot be transferred, compared to the expense of keeping track of memberships that can float from person to person.<sup>271</sup>

## V. Conclusion

This Article does not seek to reform contract law setting default rules on assignability of contract rights and obligations. Rather, it explains why contracting parties do what they do. It begins with the general principle that parties will choose assignability, non-assignability or something in between when that choice maximizes the joint value of the contract to the parties and therefore is mutually beneficial; and with the default presumption that freely alienable contracts, like freely alienable property, is welfare maximizing.

From this, it bores into more specific illustrations of the mutual-benefit general principle by discussing reasons why in certain contexts assignability is not valuable. Three of them have to do with concerns that the cost or value of performance will change when an assignment occurs

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<sup>267</sup> See, e.g., *In re I.D. Craig Serv. Corp.*, 138 B.R. 490, 492 (Bankr. W.D. Pa. 1992) (noting that Pittsburgh Steelers season tickets contained the “right to transfer the [ticket holder] status via a written request and payment of a fine dollar transfer fee”); *Yarde Metals, Inc. v. New England Patriots Ltd. P’ship*, No. 20033832E, 2003 WL 23197954 \*3 (Mass. Super. Ct. Dec. 26, 2003) (noting that New England Patriots season tickets were transferable “either by paying a transfer fee or by permission” (citations omitted)).

<sup>268</sup> See *Chrysler, Warranty Coverage*, at <http://www.chrysler.com/crossbrand/warranty> (last visited Mar. 29, 2004) (noting that the “7-year or 70,000 mile limited warranty on the powertrain” is “[t]ransferable to second owner with fee.”).

<sup>269</sup> See *supra* notes 199–200.

<sup>270</sup> See AAA Northern New England, Membership Card (on file with author) (“Service is for named member only — Non-transferable.”).

<sup>271</sup> It is also possible that restrictions on transfer are meant to prevent more than one person from using membership privileges that were priced and sold with the expected cost of providing membership services to a single person. See *supra* section III.A.2.a).

— when one party’s desired conduct is too costly to specify; when the effectiveness of remedies varies against different potential contracting partners; when one party bears another’s non-conduct-related risk. Two reasons are not concerned with the cost or value of performance — price discrimination and the administrative costs of assignment. These categories are not perfectly pure — they run together a bit at the margins; nor are they mutually exclusive — contracts may be non-assignable because more than one of the above five reasons apply. Nevertheless, they provide more specific explanatory guidance than the general label “personal service contract” and are helpful in analyzing why a particular contract is or is not made assignable by the parties.

This Article also discusses factors that could make free assignability particularly valuable — such as the ability to overcome holdout problems or long-term contracts where one party’s valuation may sharply fall over time — even when one of the above five reasons for restricting assignment applies.

The result is a more comprehensive and nuanced treatment of actual practices in contract assignment and its limits than exists in the current literature.