

# COMMERCIAL & BUSINESS LITIGATION



[Home](#) > [ABA Groups](#) > [Section of Litigation](#) > [Committees](#) > [Commercial & Business](#) > [Contract Boilerplate for Litigators](#) > >>> [Non-Assignability of Contracts Without Counterparty Consent](#)

## Non-Assignability of Contracts Without Counterparty Consent

Yvette V. Mishev – February 28, 2018

### What Is a Non-Assignment Provision and Why Do You Need It?

Generally speaking, contracts can be freely assigned to third parties. Non-assignment provisions are designed so that contracts cannot be as freely assigned to third parties; or at least, not without first obtaining the contracting counterparty's consent. The purpose of a non-assignment provision is to ensure that the identities of the original two contracting parties remain the same throughout the term of the contract. A basic non-assignment provision reads something like the following:

- "This contract cannot be assigned to anyone without the written consent of both parties."

A non-assignment provision is highly recommended if the service or product contracted for is unique to the party being contracted with and/or if the identity of the service or product provider is valued as much as the service or product being provided.

For example, if Layla contracts Monique Lhuillier to make a dress for her wedding, a part of the benefit Layla is bargaining for is a dress designed by Monique Lhuillier. Consequently, if Monique Lhuillier assigned the design and making of the dress to a third party, Wal-Mart, even if the final product was on par with a Monique Lhuillier gown in every way, Layla would nonetheless be deprived of the benefit she bargained for when she contracted Monique Lhuillier—having a wedding dress designed *by* Monique Lhuillier. A non-assignment provision safeguards the contracting parties' exclusive relationship under the contract; it ensures that Monique Lhuillier designs Layla's dress.

### Which Contractual Rights Are Assignable?

There are two types of rights one can assign under a contract—the right to receive performance under the contract, and the right to

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delegate performance. If a contract contains a basic non-assignment provision like the illustration above, a contracting party may still be able to assign its rights to receive performance under the contract, without acquiring its counterparty's consent. In some states, a party that has fully performed under a contract can freely assign its right to enforce the other party's liability despite the existence of a non-assignment provision in the governing contract, because the right to money is not considered personal in nature. *E.g. Mail Concepts, Inc. v. Foote & Davies, Inc.*, 409 S.E.2d 567 (Ga. Ct. App. 1991); *Kenneth D. Corwin, Ltd. v. Missouri Medical Service*, 684 S.W.2d 598, 600 (Mo. App. 1985).

For example, in some states, if Monique Lhullier designs Layla's wedding dress but, in turn, Layla does not perform her end of the contract—payment for the dress—Monique Lhullier may be able to assign her right to payment to a third party—despite the contract having a non-assignment provision. And when rights to payment under a contract are assigned, the assignee not only gets a right to the outstanding balance owed but is also entitled to pursue any and all default remedies provided for in the contract.

To further assure that neither contracting party can assign its rights to payment under the contract without first obtaining the counterparty's consent, the non-assignment provision should explicitly address the issue. Courts will give effect to contract provisions that specifically prohibit the assignment of one's right to receive money due under a contract. *See Raytown Consol. Sch. Dist. No. 2 v. Am. Arbitration Assoc.*, 907 S.W.2d 189, 191 (Mo. Ct. App. 1995).

The following is an example of a non-assignment provision encompassing the right to payment:

- "This contract cannot be assigned to anyone without the written consent of both parties. No party to this contract has the power to sell, mortgage, encumber, or anticipate the future payments by assignment or otherwise."

*See, e.g. In re Kaufman*, 37 P.3d 845 (Okla. 2001).

### All Non-Assignment Provisions Are Not Created Equal

Like any contract provision, a non-assignment provision must contain clear and unambiguous language. It is important to anticipate the circumstances you wish to avoid and include language to reflect that. A non-assignment provision should be clear about the consequences of the counterparty's breach.

In some jurisdictions, assignment of rights under a contract containing a non-assignment provision without the counterparty's consent would qualify as a breach and would entitle the non-breaching party to damages, but all other obligations under the contract would remain intact and enforceable against the non-breaching party and assignee.

For example, the Supreme Court of Connecticut has held that without express contractual language providing otherwise, a provision restricting the assignment of a contract will be construed

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to be a covenant like any other contractual covenant, so that a breach will render the breaching party liable in damages but will not make the contract a nullity. *David Caron Chrysler Motors, LLC v. Goodhall's, Inc.*, 43 A.3d 164 (Conn. 2012) (collecting cases from other jurisdictions). Once assigned, the contract is voidable—it has been breached but the burden is on the original counterparty to sue the assignor for damages. The assignee would still be entitled to his assigned rights. *Wheelabrator Techs. of N. Am., Inc. v. Fin. Sec. Assur. of Oklahoma, Inc.*, No. 88 CIV. 7623 (LMM), 1990 WL 180552, at \*3 (S.D.N.Y. Nov. 15, 1990) (New York law).

In other jurisdictions, however, the contract becomes void upon assignment. *Physicians Neck & Back Clinics, P.A. v. Allied Ins. Co.*, No. A05-1788, 2006 WL 2053142, at \*4 (Minn. Ct. App. July 25, 2006). Applied to the dressmaking illustration from before—Layla contracts with Monique Lhullier to make her wedding dress in exchange for money and widgets. Monique Lhullier then assigns the contract to Wal-Mart. Wal-Mart makes the dress and Layla accepts but does not deliver the widgets to Wal-Mart. Wal-Mart then sues Layla for breach of the contract. Wal-Mart could not sue Layla for breach of contract because Monique Lhullier's assignment to Wal-Mart, without Layla's consent rendered the contract void.

There are also jurisdictions where the effect of assignment in the face of a non-assignment provision requires a fact sensitive inquiry. *Bank of America, N.A. v. Mogila*, 330 F.3d 942 (7th Cir. 2003) ("the question whether breach of the promise discharges the obligor's duty depends on all the circumstances.") *citing to* Restatement (Second) of Contracts § 322(2).

To avoid surprises and ensure that assignment without your consent renders the contract void, the contract must explicitly provide that "assignment without consent will result in the assignment (or contract) being null and void."

### **"Assignment" Should Be Defined**

A non-assignment provision should also make clear whether it applies to change of control transactions where assignment of ownership of the contracting party occurs, either through a merger or a sale. For example, in some jurisdictions, where a non-assignment provision in a contract does not explicitly prohibit a transfer of property rights to a new entity by merger, the general rule is that the court should not presume the parties intended to prohibit the merger. *Tenneco Auto. Inc. v. El Paso Corp.*, 2002 WL 453930, at \*3-4 (Del. Ch. Mar. 20, 2002) (noting that the Court looks to whether the nonmerging party would suffer "any adverse consequences" as a result of the merger).

### **Consent Must Be Withheld in Good Faith**

But even if the contract has a clear, explicit non-assignment provision requiring a counterparty's consent does not mean that consent can be freely withheld. In numerous jurisdictions, if the non-assignment provision itself does not account for circumstances

under which consent may be withheld, the provision is interpreted in accordance with the implied covenant of good faith and fair dealing which requires the exercise of reasonableness and good faith in deciding whether to consent to a proposed assignment.

*Dick Broad. Co. of Tennessee v. Oak Ridge FM, Inc.* 395 S.W.3d 653, 662 (Tenn. 2013) (collecting cases).

For example, in Alabama, consent cannot be withheld merely because doing so would be financially rewarding. The Alabama Supreme Court held that it was unreasonable to deny consent to an assignment of a lease just so the landlord may charge a higher rent than was originally contracted. *The Pantry, Inc. v. Mosley*, 126 So. 3d 152 (Ala. 2013). It reasoned that the landlord's desire for a better bargain than it contracted for had nothing to do with the permissible purposes of the restraint on alienation—to protect the landlord's interest in the preservation of the property and the performance of the contract.

### **Conclusion**

Non-assignment provisions are governed by contract law, which generally varies state by state, but the end goal is always the same—to give effect to the parties' intent. Thus, a non-assignment provision should clearly and explicitly set forth the contracting parties' intent and anticipate all possibilities.

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