

THIRD PARTY BENEFICIARIES

Third Party Beneficiaries

- Privity of contract - the relationship between the two parties to a contract that confers a right to take action on the contract.
- Third Party Beneficiary - a person who is not a party to a contract, but has legal rights to enforce the contract or share in proceeds because the contract was made for the third party's benefit.

History and Introduction

- 19th Century England - Only a party in privity could enforce a contract
- U.S. - *Lawrence v. Fox*, 20 N.Y. 268 (1859).

The First Restatement of Contracts § 133 (1932)

- There are three classes of third-party beneficiaries:
- "(a) a donee beneficiary if it appears from the terms of the promise in view of the accompanying circumstances that the promisee in obtaining the promise of all or part of the performance thereof is to make a gift to the beneficiary or to confer upon him a right against the promisor to some performance neither due nor supposed or asserted to be due from the promisee to the beneficiary;

The First Restatement of Contracts § 133 (1932) Cont.

- "(b) a creditor beneficiary if no purpose to make a gift appears from the terms of the promise in view of the accompanying circumstances and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary, or a right of the beneficiary against the promisee which has been barred by the Statute of Limitations or by a discharge in bankruptcy, or which is unenforceable because of the Statute of Frauds;
- "(c) an incidental beneficiary if neither the facts stated in Clause (a) nor those stated in Clause (b) exist."

The Test of Intent to Benefit - Whose Intent Do We Seek?

- Some cases support each of Promisee and Promisor. Better rule looks to Promisee and the issue of why did the Promisee extract the promise.
- Presumption is that the parties contract only for their own benefit, but if there is an express agreement that a third party shall have rights of enforcement, that agreement will be honored by the court.
- Agreement can bar the existence of third parties by saying there will be no third party beneficiaries.
- In the absence of express intent, court will look to whether it is clear that the promisor's performance was to run directly to the third party

Lucas v Hamm, 56 Cal 2d 583 (1961)

- Modern trend is to follow *Lucas v. Hamm*.
- Reliance of alleged TBP is a factor considered by courts.
- TPB need not be identified by name in (or even alive at the time of) the contract.

The Second Restatement § 302. Intended and Incidental Beneficiaries

- (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.
- (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

Public Contracts

- If the promisor agrees to perform services for the governmental unit which unit is under a legal duty to perform to individual members of the public, individuals may recover from the promisor a creditor beneficiary if the promisor breaches.
- Restatement 2d § 313. Government Contracts.
- (1) The rules stated in this Chapter apply to contracts with a government or governmental agency except to the extent that application would contravene the policy of the law authorizing the contract or prescribing remedies for its breach.

Public Contracts

- Restatement 2d § 313. Government Contracts. Cont.
- (2) In particular, a promisor who contracts with a government or governmental agency to do an act for or render a service to the public is not subject to contractual liability to a member of the public for consequential damages resulting from performance or failure to perform unless
 - (a) the terms of the promise provide for such liability; or
 - (b) the promisee is subject to liability to the member of the public for the damages and a direct action against the promisor is consistent with the terms of the contract and with the policy of the law authorizing the contract and prescribing remedies for its breach.
- For liability to the general public to attach, the contract must manifest an intention to compensate the individual members of the public in the event of a default

Promisor's Defenses and Counterclaims

- General rule - Promisor may assert against TPB any defenses available against Promisee.
- Defenses include:
 - Fraud
 - Mistake
 - Lack of consideration
 - Illegality
 - Statute of Limitations
- TPB subject to any arbitration clause in the agreement.

Promisor's Defenses and Counterclaims

- Exceptions
 - These defenses against TPB can be waived in the original agreement
 - Employer may not assert against employee defenses it may have against the union.
- Counterclaims - Promisor may assert against TPB counterclaims against promisee arising out of the same transaction. The counterclaim functions only as a defense, there can be no affirmative recovery.

Vesting

- The issue of vesting deals with whether the promisee and promisor, after creation of TPB, can terminate or limit TPB's rights. Rights may be terminated or limited before vesting but not after.
- Restatement 2d § 311. Variation of a Duty to a Beneficiary
 - (1) Discharge or modification of a duty to an intended beneficiary by conduct of the promisee or by a subsequent agreement between promisor and promisee is ineffective if a term of the promise creating the duty so provides.
 - (2) In the absence of such a term, the promisor and promisee retain power to discharge or modify the duty by subsequent agreement.

Vesting, cont.

- (3) Such a power terminates when the beneficiary, before he receives notification of the discharge or modification, materially changes his position in justifiable reliance on the promise or brings suit on it or manifests assent to it at the request of the promisor or promisee.
- (4) If the promisee receives consideration for an attempted discharge or modification of the promisor's duty which is ineffective against the beneficiary, the beneficiary can assert a right to the consideration so received. The promisor's duty is discharged to the extent of the amount received by the beneficiary.

Vesting - Alternate View

- Rights vest upon TPB's learning of agreement and assenting to it.
- Donee Beneficiary - Restatement 1st - Rights vest immediately on making of the contract.
- Modern view - Donee beneficiary gets no better rights than a creditor beneficiary.

Rights of the Beneficiary Against the Promisee

- Creditor beneficiary - Does not lose original rights against the promisee.
- Donee beneficiary - Ordinarily has no rights against the promisee.

Rights of the Promisee Against the Promisor

- Promisee, as party to the agreement, has rights of enforcement when agreement is breached.