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## Perfecting the Third Party Beneficiary Standing Rule Under Section 302 of the Restatement (Second) of Contracts

Harry G. Prince

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## PERFECTING THE THIRD PARTY BENEFICIARY STANDING RULE UNDER SECTION 302 OF THE RESTATEMENT (SECOND) OF CONTRACTS†

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INTRODUCTION

The matter of contract third party beneficiary rights is not simply a topic for academic discussion but is a subject that should be of measurable concern to every practicing lawyer whose clients have even a minimal involvement in the American socio-economic environment. Contract law impacts in a most pervasive way not only upon business transactions but also upon such personal things as terms of employment, the purchase of a home and other necessities of life, and even the enjoyment of most luxuries. And whenever a contract exists between parties, whether business or personal in nature, some third party will almost always be affected by the performance or non-performance of the agreement. In the event of non-performance or breach, the third party may endeavor to bring suit for enforcement of the contract made between the other parties. Consequently lawyers planning contractual relations should be concerned with the possibility of third party beneficiary claims and the changing nature of the law in this area.

Any doubt about the vast potential for assertion of third party beneficiary standing is quickly dispelled by a cursory review of recently reported cases. Such a survey uncovers a wide range of cases that includes not only the expected construction, real estate sales, and employment contract cases but also such diverse claims as those related to resettlement of refugees,<sup>1</sup> disposal of nuclear waste,<sup>2</sup> the building of nuclear power plants,<sup>3</sup> the care of

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<sup>1</sup> *Nguyen v. U.S. Catholic Conference*, 548 F. Supp. 1333 (W.D. Pa. 1982). This case involved a claim by Vietnamese refugees that the defendant relief agency had not properly administered a resettlement program pursuant to a grant agreement between the relief agency and the United States Government. The court denied relief on the grounds that the agreement included no assumption of direct liability to the refugees by the relief agency nor evidence that any rights were intended to vest directly in individual refugees. *Id.* at 1348-49.

<sup>2</sup> *New York State Energy Research and Development Authority v. Nuclear Fuel Services, Inc.*, 561 F. Supp. 954 (W.D. N.Y. 1983). In this case the court denied the contract third party beneficiary claim on the curious grounds that the same relief sought was available on alternative theories of trespass and unjust enrichment. *Id.* at 980.

The case focused on an attempt by the owner-lessor of a nuclear fuels disposal and reprocessing center to require the removal of spent nuclear fuel by those utility customers who had stored spent fuel at the center under agreements with the former lessee-operator of the center, Nuclear Fuel Services Inc. (NFS). The contracts between NFS and the utilities included provisions which required, in essence, that the utilities remove the spent fuel at the request of NFS in the event its lease should be terminated by the owner. *Id.* at 961.

After some equivocation the court concluded that the owner was not a third party beneficiary of the contracts between NFS and the utilities because the relief sought was available on alternative legal theories. *Id.* at 980. There can be no doubt that NFS contracted with a concern that it should be able to require removal of the spent fuel if it lost the lease and that the utilities should have been aware of

adopted children,<sup>4</sup> the strikes of public employees,<sup>5</sup> the provision of family planning services,<sup>6</sup> the rights of international air passengers,<sup>7</sup> liability in asbestosis cases,<sup>8</sup> and student eligibility for collegiate athletics.<sup>9</sup> The practical and academic interest in third party beneficiary rights, however, should spring not only from the inherent potential for third party claims in contractual arrangements, but also from the possibilities for the

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this concern and the intent to accommodate the interest of the owner. Under even the most restrictive intent standards as set out below, *see infra* notes 74-96 and accompanying text, the decision and reasoning in this case are at best extremely questionable and almost certainly incorrect.

<sup>3</sup> *County of Suffolk v. Long Island Lighting Co.*, 554 F. Supp. 399 (E.D. N.Y. 1983), *aff'd*, 728 F.2d 52 (2d Cir. 1984). The county sought to advance a claim based on the defendants' alleged breach of their construction permit agreement with the Nuclear Regulatory Commission (NRC) and its predecessor, the Atomic Energy Commission (AEC), governing the construction of the Shoreham Nuclear Power Station. The court held, *inter alia*, that the county was not a third party beneficiary of the construction permit agreement. *Id.* at 409.

<sup>4</sup> *Bradford v. Davis*, 290 Or. 855, 626 P.2d 1376 (1981). A foster child brought suit against the Oregon Department of Human Services and others alleging, *inter alia*, that he was a third party beneficiary of a contractual promise by the defendant that he would be placed in an adoptive home in consideration for his parents relinquishment of their parental rights. In reversing the lower court denial of the contract claim and remanding for further consideration the Supreme Court of Oregon distinctly left open the possibility that the foster child might indeed be a third party beneficiary with standing to sue the defendants for failure to provide adoptive care. *Id.* at 866, 626 P.2d at 1383. *But cf.* *Rubin by Rubin v. Hainst Medical Center*, 478 A.2d 869, 872 (Pa. Super. 1984) (court held that child born with birth defect could not recover as third party beneficiary for alleged breach by medical laboratories and physicians of contracts with parents for medical testing services).

<sup>5</sup> *Burns Jackson Miller Summit & Spritzer v. Linder*, 88 A.D.2d 50, 452 N.Y.S.2d 80 (1982), *aff'd*, 59 N.Y.2d 314, 464 N.Y.S.2d 712 (1983); *Burke & Thomas, Inc. v. International Organization of Masters*, 92 Wash. 2d 762, 600 P.2d 1282 (1979). In both these cases suits were brought against transit workers' unions by injured businesses for breach of "no-strike" clauses in their contracts with the transit authorities. Similar decisions were reached in both cases that the transit unions assumed no direct liability to the businesses that might be adversely affected by illegal strikes. *Burns Jackson*, 88 A.D.2d at 75-76, 452 N.Y.S.2d at 95; *Burke & Thomas, Inc.*, 92 Wash. 2d at 767-68, 600 P.2d at 1285-86.

<sup>6</sup> *McFarland v. Atkins*, 594 P.2d 758 (Okla. 1978). Dismissal of the third party beneficiary claim brought by the plaintiff-citizen was affirmed in the absence of an allegation that the plaintiff-citizen was an express beneficiary of the contract between the Planned Parenthood charitable organization and the state health agency for the provision of family planning services. *Id.* at 763. Plaintiff had alleged that the Planned Parenthood organization breached its contract and violated state law by distributing birth control information and services to minors in an improper manner. *Id.* at 760.

<sup>7</sup> *In re Air Crash Disaster at Warsaw, Poland*, 535 F. Supp. 833 (E.D. N.Y. 1982). American passengers and their heirs were found to be third party contract beneficiaries of an international agreement providing terms for liability of airlines resulting from air crash and death of qualifying passengers. *Id.* at 836.

<sup>8</sup> *Oman v. Johns-Manville Corp.*, 482 F. Supp. 1060 (E.D. Va. 1980), *vacated*, 662 F.2d 234 (4th Cir. 1981). The manufacturers of asbestos products were sued by employees of a shipbuilding firm which purchased and used the asbestos products. The employees sought to recover from the manufacturers for injuries resulting from the acquisition or aggravation of asbestosis through exposure to dust from the asbestos products. In turn, the manufacturers sought indemnification from the employers on the reasoning that they, the manufacturers, were third party beneficiaries of an employment contract requirement that the employer provide employees with a safe place to work, including proper handling of the asbestos products. The court held that the employment contract revealed no intent to confer a benefit upon the asbestos products manufacturers. *Id.* at 1063-64.

<sup>9</sup> *English v. National Collegiate Athletics Association*, 439 So. 2d 1218 (La. 1983). The plaintiff was a student-athlete who sought to be declared eligible for a last year of competition despite a ruling by the National Collegiate Athletic Association (NCAA) that he was ineligible. In the law suit, the student unsuccessfully sought third party beneficiary standing on the participation contract between the college and the NCAA. *Id.* at 1223.

deliberate and strategic use of third party beneficiary arrangements in structuring transactions or pursuing remedies for wrongful conduct.<sup>10</sup> Present developments in the law governing third party beneficiary standing, including the adoption of new rules in some states<sup>11</sup> and the recent emergence of a new standard in Section 302 of the Restatement (Second) of Contracts,<sup>12</sup> render this topic timely for consideration.

<sup>10</sup> The variety of uses include the transfer of property after death without use of a will, *see, e.g.*, *Baker v. Bank of Northeast Arkansas*, 271 Ark. 948, 951, 611 S.W.2d 783, 785 (1981); *Marosites v. Proctor*, 59 N.C. App. 353, 354, 296 S.E.2d 526, 527 (1982); the avoidance of shorter statutory limitation periods that may apply to tort actions, *Western Union Telegraph Co. v. Massman Construction Co.*, 402 A.2d 1275, 1277-78 (D.C. 1979); *see, e.g.*, *Millwright v. Romer*, 322 N.W.2d 30, 33-34 (Iowa 1982); the establishment of standing under federal programs where no statutory private cause of action can be had, *see, e.g.*, *Beverly v. Macy*, 702 F.2d 931, 942-43 (11th Cir. 1983); *Zigas v. Superior Court of San Francisco*, 120 Cal. App. 3d 827, 834-35, 174 Cal. Rptr. 806, 809-10 (1981); and, as generally used, the establishment of standing against a remote party when a more immediate party is absent, judgment proof, or simply not in breach of a contract.

<sup>11</sup> *See infra* notes 25-27 and accompanying text.

<sup>12</sup> The American Law Institute [hereinafter "ALI"] began its work on the Restatement (Second) of Contracts in 1962 and completed it in 1979. *See* RESTATEMENT (SECOND) OF CONTRACTS, Volume I-Forward at VII (1981). The earliest revision of RESTATEMENT OF CONTRACTS SECTION 133 (1932), pertaining to third party beneficiary standing, appeared in Tentative Draft No. 3 (1967) as Section 133. The current text first appeared in the revised and edited version of Tentative Drafts Nos. 1-7 (1973), still at Section 133, but was finally published as Section 302 in 1981. *See* RESTATEMENT (SECOND) OF CONTRACTS § 302, Reporter's Note (1981).

The text of Section 302 is:

§ 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.

The text of RESTATEMENT OF CONTRACTS SECTION 133 (1932) is:

§ 133. Definition of Donee Beneficiary, Creditor Beneficiary, Incidental Beneficiary.

(1) Where performance of a promise in a contract will benefit a person other than the promisee, that person is, except as stated in Subsection (3):

- (a) a donee beneficiary if it appears from the terms of the promise in view of the accompanying circumstances that the purpose of 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;
- (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.

(2) Such a promise as is described in Subsection (1)(a) is a gift promise. Such a promise as is described in Subsection (1)(b) is a promise to discharge the promisee's duty.

(3) Where it appears from the terms of the promise in view of the accompanying circumstances that the purpose of the promisee is to benefit a beneficiary under a trust

The claimants in the rather unusual cases referred to in the preceding paragraph were mostly unsuccessful in seeking standing as third party beneficiaries, and properly so.<sup>13</sup> In the more common cases, however, the decisions of the courts are often not so clearly correct. Indeed, both of the late Professors Arthur Linton Corbin and Samuel Williston, authors of the two classic treatises on contract law,<sup>14</sup> singled out the area of third party beneficiary rights as one involving particular inconsistency and uncertainty.<sup>15</sup> Nevertheless, as Professor Corbin noted in his writing on this subject, a discernible trend does exist in the cases.<sup>16</sup> Very simply put, nearly all jurisdictions have agreed that the test for recognizable third party beneficiary rights is evidence that the contracting parties intended the third party to benefit substantially from the promised performance.<sup>17</sup> The premise is that only when such intent to benefit is present should a person who is not a party to the contract have standing to seek legal enforcement of the promised performance.

The intent to benefit test, although seemingly straightforward, has proven to be very difficult to apply in a consistent manner.<sup>18</sup> Problems encountered in applying the basic test have resulted in the development of subsidiary or collateral rules in the individual states which vary to a significant degree.<sup>19</sup> The combination of the difficulty in applying the intent to benefit test plus the variance in collateral state rules has produced a good amount of inconsistency among the states in decisional law and has also given rise to decisions within single jurisdictions that are noticeably at odds.<sup>20</sup> These difficulties have undoubtedly contributed to the occasional inclination of courts to avoid third party standing questions if another basis for decision is available.<sup>21</sup> Moreover, the courts have found it difficult to be precise in the reasoning of third party beneficiary cases and have occasionally decided that third party rights did not exist when the decision ought to have been that relief was not warranted for some other reason.<sup>22</sup> The imprecise decisions

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and the promise is to render performance to the trustee, the trustee, and not the beneficiary under the trust, is a beneficiary within the meaning of this Section.

<sup>13</sup> See *supra* notes 1-9. Only the case of *New York State Energy Research and Development Authority v. Nuclear Fuel Services*, 561 F. Supp. 954, 979 (W.D. N.Y. 1983), is clearly questionable in its conclusion on and reasoning of the third party beneficiary claim when examined in light of the prevailing rules as discussed *infra* at notes 41-122 and accompanying text. See *supra* note 2.

<sup>14</sup> A. CORBIN, *CORBIN ON CONTRACTS* (1951) [hereinafter cited as A. CORBIN, *CONTRACTS*]; S. WILLISTON, *CONTRACTS* (3d ed. 1959).

<sup>15</sup> 2 S. WILLISTON, *CONTRACTS* § 347 (3d ed. 1959); 4 A. CORBIN, *CONTRACTS* § 772 (1951).

<sup>16</sup> 4 A. CORBIN, *CONTRACTS* § 772 (1951).

<sup>17</sup> See 2 S. WILLISTON, *CONTRACTS* § 356A (3d ed. 1959); 4 A. CORBIN, *CONTRACTS* § 776 n.21; 17 AM. JUR. 2d *Contracts* § 304 (1964).

<sup>18</sup> For other discussions of the difficulties, see Jones, *Legal Protection of Third Party Beneficiaries: On Opening Courthouse Doors*, 46 U. CIN. L. REV. 313 (1977) [hereinafter cited as Jones]; Note, *Third Party Beneficiaries and the Intention Standard: A Search for Rational Contract Decision-Making*, 54 VA. L. REV. 1166 (1968); Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406 (1957).

<sup>19</sup> See *infra* notes 41-122 and accompanying text.

<sup>20</sup> See *infra* notes 123-331 and accompanying text.

<sup>21</sup> See, e.g., *New York State Energy and Research Development Authority v. Nuclear Fuel Services, Inc.*, 561 F. Supp. 954 (W.D. N.Y. 1983) (discussed *supra* note 2); *Needham v. Hamilton*, 459 A.2d 1060, 1062 (D.C. 1983) (preferring to allow intended beneficiary of ineffective will to sue drafting attorney on malpractice theory rather than decide whether third party contract beneficiary rights existed).

<sup>22</sup> Even when a party is able to satisfy the test for third party standing by showing the requisite intent to benefit, other questions must be addressed before recovery will be proper. As a preliminary matter, the contract must be valid as between the contracting parties because the third party cannot enforce a contract that the promisee could not enforce against the promisor. See, e.g., *State v.*

establish bad precedent and amplify the other difficulties in third party beneficiary law.

These compounded difficulties have given rise to efforts to improve and clarify the law in two arenas. First, some state courts, most noticeably in Massachusetts, Minnesota, Pennsylvania, and West Virginia, as well as federal courts applying federal common law, have begun to move toward improved third party beneficiary standing rules. Second, the draftsmen of the Restatement (Second) of Contracts acknowledged the difficulties involved in applying the test embodied in Section 133 of the original Restatement of Contracts<sup>23</sup> and therefore revised the standard.<sup>24</sup> These two developments are related. In Pennsylvania the prior law was supplemented by adoption of the new Section 302 formulation,<sup>25</sup> and in Massachusetts the prior law, which denied explicit recognition to third party rights, was overruled by adoption of Section 302.<sup>26</sup> The Supreme Court of Minnesota recently adopted the new approach of Section 302 in place of its former law which had incorporated Section 133 of the first Restatement of Contracts.<sup>27</sup> The Supreme Court of West Virginia has indicated it will adopt a new rule at the next opportunity<sup>28</sup> and one can confidently predict that the formulations found in the original and newer Restatements will be considered by the court at that time. Finally, although the federal

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Osborne, 607 P.2d 369, 371 (Alaska 1980) (citing RESTATEMENT (SECOND) OF CONTRACTS § 140 (Tent. Draft 1973)) (now found at RESTATEMENT (SECOND) OF CONTRACTS § 309 (1981)). See also 4 A. CORBIN, CONTRACTS § 773 (1951).

Another requirement for third party recovery is a breach of a relevant provision of the contract. For an example of confusion about this requirement, see *Clearwater Key Association — South Beach, Inc. v. Thacker*, 431 So. 2d 641 (Fla. 1983). In this case the plaintiffs were owners of two contiguous condominium units. The original management company had assessed only one management fee against the plaintiffs under a provision in the agreement between the management company and the condominium association which specifically indicated that these two units would be subject to only one management fee. After proper termination of the original management agreement, subsequent managers assessed two management fees against the plaintiff. The appellate court held, *inter alia*, that the plaintiffs were not intended beneficiaries of the original management agreement. *Id.* at 645. While proper termination of the original management agreement would properly extinguish the rights of third party beneficiaries of the agreement, it was undeniably poor reasoning for the court to indicate that the plaintiffs were not third party beneficiaries of a contract which included a specific provision inserted to limit their monetary obligations under the condominium arrangement.

<sup>23</sup> See *infra* notes 351-54 and accompanying text.

<sup>24</sup> See *supra* note 12.

<sup>25</sup> *Guy v. Liederbach*, 501 Pa. 47, 459 A.2d 744 (1983). The Supreme Court of Pennsylvania overruled prior law to the extent that it stated the exclusive test for third party beneficiaries and adopted the Restatement (Second) of Contracts, Section 302 as an alternative test supplementing the prior law. *Id.* at 59-60, 459 A.2d at 751.

<sup>26</sup> *Choate, Hall & Stewart v. SCA Services, Inc.*, 378 Mass. 535, 536, 392 N.E.2d 1045, 1051 (1979). For a discussion of the prior Massachusetts law expressly denying third party rights while allowing exceptions so substantial that its decisions were largely consistent with those states recognizing the right see Note, *The Third Party Beneficiary Rule in Massachusetts*, 8 SUFFOLK U.L. REV. 130 (1973).

<sup>27</sup> *Cretex Companies, Inc. v. Construction Leaders, Inc.*, 342 N.W.2d 135, 139 (Minn. 1984). The Supreme Court of Minnesota adopted the "approach outlined in Restatement (Second) of Contracts Section 302" in lieu of its prior law which had relied on the categorization test of the first Restatement of Contracts Section 133. *Id.* at 138-39.

<sup>28</sup> *Woodford v. Glenville State College Housing Corp.*, 225 S.E.2d 671, 674-75 (W. Va. 1976). The current West Virginia law is that the contract must exist for the sole benefit of the third party before standing may be had. The majority of the court questioned this restrictive rule in the above case but failed to adopt a new rule because the contract was not at all intended for the benefit of the plaintiff and he could not have recovered under even the most liberal standard. *Id.*

courts are far from uniform in applying third party beneficiary rules under federal common law, some courts have made use of Section 302 in recent cases in conjunction with or in lieu of more traditional tests.<sup>29</sup>

These efforts to improve the law through adoption of Section 302 will be successful only if that formulation proves to be an improvement over prior law and lends itself to a construction which alleviates present difficulties. To date, those courts which have considered the newer Restatement formulation have not been uniform in accepting or construing the section and the changes it embodies.<sup>30</sup> Some courts have perceived a significant change from the original Restatement while others have not;<sup>31</sup> some courts have evidenced a willingness to adopt Section 302 while others have expressly or implicitly indicated a continuing preference for the original Section 133 formulation.<sup>32</sup>

At this juncture, when the use of third party claims continues to be substantial and diverse, when courts are either making wholesale changes in third party beneficiary law or changing pre-existing rules in a slower, less visible manner, and when Section 302 remains amenable to beneficial, interpretative construction, a review of the prevailing state rules and their recent applications would be helpful in establishing an interpretation of Section 302 which would best alleviate current problems and achieve greater harmony among the states. This article analyzes the components of the various formulations of third party beneficiary rules currently found in state and federal common law<sup>33</sup> and surveys the results of applying such rules to ordinary types of cases.<sup>34</sup> In addition, the article assesses the changes made in the Restatement formulation of the third party beneficiary standing rule<sup>35</sup> and proposes a construction of Section 302 which would result in more consistent decisions both within and among those jurisdictions that choose to adopt, or are influenced by, the new rule.<sup>36</sup>

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<sup>29</sup> See *infra* Appendix. See also *Miree v. DeKalb County*, 433 U.S. 25, 31-32 (1977) (for rule on when federal common law should apply).

<sup>30</sup> See *infra* Appendix.

<sup>31</sup> Compare *Weems v. Nanticoke Homes, Inc.*, 37 Md. App. 544, 556-57, 378 A.2d 190, 197 (1977) (viewing RESTATEMENT (SECOND) OF CONTRACTS § 302 as containing "liberalized principles") with *Reidy v. Macauley*, 57 N.C. App. 184, 186, 290 S.E.2d 746, 747 (1982) ("the 1932 Restatement test for determining third party beneficiaries remains the same under the 1979 Restatement"); and *People ex rel. Resnik v. Curtis & Davis, Architects & Planners, Inc.*, 78 Ill. 2d 381, 400 N.E.2d 918, 919-20 (1980) (citing RESTATEMENT (SECOND) OF CONTRACTS § 302 in support of Illinois state rule as established in *Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 178 N.E. 498 (1931), implying no change in the new Restatement standard). Also compare *Clark v. American Standard, Inc.*, 583 P.2d 618, 620 (Utah 1978) (the Supreme Court of Utah uses Section 302 formulation as establishing improved standard used in lieu of older creditor and donee test) with *Tracy Collins Bank & Trust v. Dickamore*, 652 P.2d 1314, 1315 (Utah 1982) (the Supreme Court of Utah cites Section 302 in support of application of creditor and donee test).

<sup>32</sup> Compare *Choate, Hall & Stewart v. SCA Services, Inc.*, 378 Mass. 535, 545-46, 392 N.E.2d 1045, 1051 (1979) and *Guy v. Liederbach*, 501 Pa. 47, 51, 459 A.2d 744, 746 (1983), (accepting new Section 302) with *Khabbaz v. Swartz*, 319 N.W.2d 279, 285 n.8 (Iowa 1982) and *Weems v. Nanticoke Homes, Inc.*, 37 Md. App. 544, 566-67, 378 A.2d 190, 197 (1977) (declining to adopt changes embodied in Section 302). For cases continuing to apply original Restatement formulation without mention of Section 302, see, e.g., *U.S. v. Dairyland Insurance Company*, 513 F. Supp. 1017, 1019 (D. N.D. 1981), modified, 674 F.2d 750 (10th Cir. 1982), *New Hampshire Ins. Co. v. City of Madera*, 144 Cal. App. 3d 298, 308-09, 192 Cal. Rptr. 548, 555 (1983); and *Wilson v. General Mortgage Co.*, 638 S.W.2d 821, 823 (Mo. Ct. App. 1982).

<sup>33</sup> See *infra* notes 41-122 and accompanying text.

<sup>34</sup> See *infra* notes 124-331 and accompanying text.

<sup>35</sup> See *infra* notes 332-456 and accompanying text.

<sup>36</sup> See *infra* notes 457-94 and accompanying text.

### I. COMMON LAW RULES ON THIRD PARTY BENEFICIARY RIGHTS<sup>37</sup>

Since the appearance of Section 302 in 1973,<sup>38</sup> the courts have been active in two ways relevant to this discussion. First, some state courts have either changed their law on third party beneficiary rights or indicated a willingness to change it,<sup>39</sup> and second, other state and federal courts have begun to respond to the new formulation found in Section 302 as either being different from or consistent with their existing law.<sup>40</sup> Before considering whether such responses to Section 302 have been correct, this article will examine recent case law to ascertain the elements of third party beneficiary rules traditionally employed by the courts. This examination will attempt to identify and evaluate those elements upon which the various jurisdictions agree and those upon which they do not.

#### A. *Presumptions and Sufficiency of Evidence*

One aspect of third party beneficiary law that appears to be generally accepted by the courts is a presumption against third party beneficiary standing. When phrased as a rule this presumption generally takes the form of either an exact statement that "parties are presumed to contract for themselves"<sup>41</sup> or other language indicating that doubts are to be construed against an intent to contract for third party rights.<sup>42</sup> Although only a portion of the states expressly recognize this presumption, a review of the rules of the other states finds the presumption recognized implicitly. More specifically, states have adopted strict rules concerning the sufficiency of the evidence of intent required to establish third party standing. These subsidiary rules generally require that the intent be "clear," "express" or "definite."<sup>43</sup> In this same vein, some states also require that the necessary intent be expressed entirely or partially in the contract itself rather than indicated by the surrounding circumstances.<sup>44</sup>

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<sup>37</sup> Many states have statutes embodying prior common law rules on third party beneficiary rights. See 2 S. WILLISTON, *CONTRACTS* § 367 (3d. 1959 & Supp. 1983). The statutory enactments, however, have not significantly changed the application of the common law rules. Reference to the statutes are made as necessary herein.

<sup>38</sup> See *supra* note 12.

<sup>39</sup> See *supra* notes 25-28.

<sup>40</sup> See *supra* notes 31-32 and *infra* Appendix.

<sup>41</sup> See, e.g., *King v. National Industries, Inc.*, 512 F.2d 29, 32 (6th Cir. 1975) (applying Kentucky law); *Brown v. Summerlin Associates, Inc.*, 272 Ark. 298, 301, 614 S.W.2d 227, 229 (1981); *Midwest Concrete Products Company v. LaSalle National Bank*, 94 Ill. App. 3d 394, 396, 418 N.E.2d 988, 990 (1981); *Lewis v. Globe Construction Co., Inc.*, 6 Kan. App. 2d 478, 486, 630 P.2d 179, 185 (1981); *Volume Services, Inc. v. C.F. Murphy & Assoc., Inc.*, 656 S.W.2d 785, 795 (Mo. Ct. App. 1983); *Clearwater Construction Co. v. Gutierrez*, 626 S.W.2d 789, 791 (Tex. Civ. App. 1981).

<sup>42</sup> See, e.g., *American Home Insurance Company v. Travelers Indemnity Company*, 122 Cal. App. 2d Supp. 951, 967, 175 Cal. Rptr. 826, 834 (1981); *Canyon View Irrigation Co. v. Twin Falls Canal Co.*, 101 Idaho 604, 612-13, 619 P.2d 122, 130-31 (1980).

<sup>43</sup> See, e.g., *Montezuma Plumbing & Heating, Inc. v. Housing Authority of Montezuma County*, 651 P.2d 426, 428 (Colo. Ct. App. 1982) ("[T]he promise to be enforced is apparent from express provisions of the agreement."); *Security Mutual Casualty Co. v. Pacura*, 402 So. 2d 1266, 1267 (Fla. Dist. Ct. App. 1981) ("[R]ight is limited to those situations where the provisions of the contract clearly show an intention . . . to benefit the individual. . . ."); *Donalson v. Coca-Cola Co.*, 164 Ga. App. 712, 713, 298 S.E.2d 25, 27 (1982) ("[I]t must clearly appear from the contract that it was intended for his benefit."); *Keel v. Titan Construction Corp.*, 639 P.2d 1228, 1231 (Okla. 1982) ("expressly for [the] benefit of the third person"); *Kelly Health Care, Inc., v. Prudential Ins. Co. of America, Inc.*, 226 Va. 376, —, 309 S.E.2d 305, 307 (1983) (intent must "clearly and definitely" be shown).

<sup>44</sup> See, e.g., *American Financial Corp. v. Computer Sciences Corp.*, 558 F. Supp. 1182, 1184-85 (D. Del. 1983) (applying Delaware law); *Norton v. First Federal Savings*, 128 Ariz. 176, 178, 624 P.2d

The thrust behind the presumption against third party rights, at least in part, is the notion that finding such rights exposes the promisor to potential liability to a "stranger" to the contract, a person who has paid no price and given no consideration for the rights.<sup>45</sup> Unless the contract can be read as expressly or definitely including the rights in the third party as a part of the bargain, the promisor is envisioned as being required to give more than he bargained for in the exchange.

In tipping the balance toward denying third party rights, the courts are making a judgment that exposing a promisor to potential liability to a third party when the promisor has not explicitly contracted to assume that obligation is more undesirable than allowing a party to completely escape the consequences of a breach of contract when the promisee is disabled from or not interested in enforcing the promise. At first glance this presumption does seem to have merit because it gives preference to a party who has given consideration rather than a party who has not. One primary challenge to the presumption, however, is the likelihood that it may not be necessary since courts may be able to decide such cases fairly without resorting to it. Without resort to this presumption, the courts would simply need to reach a decision based on the normally applicable standards of proof, namely, "preponderance or greater weight of the evidence."<sup>46</sup> In applying this normal standard for third party claimants, the worst possible fate of the promisor would be that he be required to complete his promised performance or pay damages for breach. In this sense, the promisor is not being required to give more than he bargained to give but is merely being forced by the hand of someone other than the promisee. A second basis for challenging the presumption is that it is not applied consistently. In some categories of cases the courts seem to disregard the presumption and allow third party standing, even in the absence of a "clear," "express" or "definite" expression of intent to create third party rights, when the alternative would be to allow the promisor to escape

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854, 856 (1981) (en banc); *Alevogt v. Brinkoetter*, 85 Ill. 2d 44, 54-55, 421 N.E.2d 182, 187 (1981); *Waterford Condominium Association v. Dunbar Corp.*, 104 Ill. App. 3d 371, 373, 432 N.E.2d 1009, 1011 (1982); *Haakinson & Beatty Co. v. Inland Ins. Co.*, 216 Neb. 426, 431, 344 N.W.2d 454, 458 (1984); *Hall v. Goodman Co.*, 310 Pa. Super. 465, 476, 456 A.2d 1029, 1035 (1983).

<sup>45</sup> See *German Alliance Insurance Co. v. Home Water Supply Co.*, 226 U.S. 220, 230 (1912); 2 S. WILLISTON § 347 n.4 (3d ed. 1959) (citing *Northern National Bank v. Northern Minnesota National Bank*, 244 Minn. 202, 70 N.W.2d 118 (1955)).

The U.S. Supreme Court stated in *German Alliance*:

In many jurisdictions a third person may now sue for the breach of a contract made for his benefit. The rule as to when this can be done varies in the different States. In some he must be the sole beneficiary. In others it must appear that one of the parties owed him a debt or duty, creating the privity, necessary to enable him to hold the promisor liable. Others make further conditions. But even where the right is most liberally granted it is recognized as an exception to the general principle, which proceeds on the legal and natural presumption, that a contract is only intended for the benefit of those who made it. Before a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement, to which he is not a party, he must, at least show that it was intended for his direct benefit. For, as said by this court, speaking of the right of bondholders to sue a third party who had made an agreement with the obligor to discharge the bonds, they may have had an indirect interest in the performance of the undertakings, but that is a very different thing from the privity necessary to enable them to enforce the contract by suits in their own names. *National Bank v. Grand Lodge*, 98 U.S. 123, 124; *Hendrick v. Lindsay*, 93 U.S. 143, 149; *National Savings Bk. v. Ward*, 100 U.S. 195, 202, 205.

226 U.S. at 230.

<sup>46</sup> See F. JAMES & G. HAZARD, *CIVIL PROCEDURE* §7.6, at 243 (2d ed. 1977).

liability for breach.<sup>47</sup> A third and very important basis for challenging the presumption against third party rights is that the presumption is related to an unrealistic notion that generally the parties actually have some discoverable intent concerning third party rights.<sup>48</sup> The presumption against standing ostensibly can be overcome only by clear evidence of the parties' actual, express intent to confer an enforceable right upon the third party. Since actual, express intent is not likely to be found in the majority of litigated cases,<sup>49</sup> the presumption, if strictly applied, would stand as an insurmountable bar to most third party beneficiary claims.

Even if a state rationally chose to adopt the presumption against third party standing, to reflect that prejudice in a requirement that the rebutting evidence of intent appear in the contract itself, as some states presently do,<sup>50</sup> would be patently unreasonable. Although the relevant courts have not consistently applied this requirement in the reported cases,<sup>51</sup> it yet stands as a bar not only to those cases which may be summarily dismissed but

<sup>47</sup> For a prime example, see the will drafting cases cited below at notes 153-63 and accompanying text. The presumption also is not applied in true creditor beneficiary cases. See *infra* notes 77, 126-30 and accompanying text.

<sup>48</sup> Two potentially conflicting theories that should be carefully considered converge in many of the cases. One is that the courts should limit their role to interpreting or construing the agreement of the parties and not add to its terms at all. See, e.g., *Waterford Condominium Association v. Dunbar Corp.*, 104 Ill. App. 3d 371, 373, 432 N.E.2d 1009, 1011 (1982); *Alva v. Cloninger*, 51 N.C. App. 602, 608-09, 277 S.E.2d 535, 539 (1981). This restrictive approach suggests that the parties must actually contemplate and provide for the possibility that a third party may seek to enforce the contract and that the court's role is to find and discern this actual intent of the parties. In some cases, such as the classic creditor beneficiary cases discussed *infra* at notes 76-77, even the more restrictive courts would assign to the parties, by means of interpretation, an intent to create rights in the third person even though the contract has no express statement concerning third party rights. The interpretive process obviously involves a degree of inference.

The other theory is that parties generally leave "gaps" in a contract, often including among them the failure to provide for the rights that may accrue in third persons. When a court is faced with such a gap it can properly be said that the court's role is to supply a term if supplying the term would be consistent with the contracting parties' goals and expectations. See E. FARNSWORTH, *CONTRACTS* §§ 7.16 and 10.3 (1982). In filling such a gap the court is making perhaps a somewhat greater degree of inference than in those cases of "interpretation" mentioned above.

The point of convergence of the two theories, interpretation and gap filling, is when the evidence of intent is very minimal, conflicting or inconclusive. The distinction between interpretation and gap filling then becomes very uncertain. Rather than attempt to distinguish between these two functions, courts might find it more effective and efficient to establish clear standards for what factors and circumstances will support an inference, whether it be interpretive or supplementary, that third party rights should be permitted as consistent with the manifest terms and goals of the contracting parties. Attempts to restrict third party rights to those instances where actual intent to confer rights supposedly can be found will lead the courts to engage in unproductive and distractive exercises.

<sup>49</sup> See E. FARNSWORTH, *CONTRACTS* § 10.3. If the contracting parties do clearly provide for third party rights, the courts' task of enforcing the terms is straightforward. For most litigated cases, as with practically every case cited in this article, the parties have failed to include clear provisions concerning third party standing, probably because there was no contemplation of that issue.

The drafters of the Restatement (Second) of Contracts also seem to have viewed these cases as largely involving instances in which the contracting parties did not consider or possess any actual intent concerning third party standing. See *infra* notes 372-75.

<sup>50</sup> See *supra* note 44.

<sup>51</sup> See, e.g., *Norton v. First Federal Savings*, 128 Ariz. 176, 178, 624 P.2d 854, 856 (1981) (en banc) (the court went on to look to other extrinsic evidence after stating the intent must be found in contract and having concluded that the contract evidenced no intent); *Local 80 Sheet Metal Workers International Association, AFL-CIO v. Tishman Construction Corp.*, 103 Mich. App. 784, 789, 791,

also to potential claimants who may refrain from pursuing actions in the face of the requirement. Indeed, cases exist in which courts have abbreviated their consideration of the third party standing question in light of this requirement.<sup>52</sup> The major fault in such a process is that it applies a rather arbitrary and wooden rule rather than encouraging a search for a course of performance that fairly comports with the discoverable intent of the parties.

Two cases stand as particularly good examples of the unreasonableness of the requirement that intent appear in the express terms of the contract. The United States Court of Appeals for the Fifth Circuit decided the case of *Beckman Cotton Company v. First National Bank of Atlanta*<sup>53</sup> applying Georgia law. At issue in *Beckman* was a claim of third party standing by a person not listed as payee under a letter of credit because of a federal financing program requirement, but who was unquestionably the real party interested in performance by the defendant bank.<sup>54</sup> The Georgia state courts had recently reaffirmed

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303 N.W.2d 893, 895-96 (1981) (after indicating that "the intention as disclosed by the terms of the contract, governs," the court decided that the provisions of a different contract than the contract sued upon were "dispositive of the third-party beneficiary action"). Compare *Montezuma Plumbing & Heating, Inc. v. Housing Authority of Montezuma County*, 651 P.2d 426, 428 (Colo. Ct. App. 1982) (Colorado rule stated to be that third party standing must be apparent from express provisions), with *Concrete Contractors, Inc. v. E.B. Roberts Construction Co.*, 664 P.2d 722, 725 (Colo. 1983) (proof of intent to benefit third party was not present in contract but derived entirely from surrounding circumstances and conduct of parties).

Also compare statements of Illinois law requiring intent to be determined from "within the language of the contract," *Securities Fund Services, Inc. v. American National Bank and Trust Company of Chicago*, 542 F. Supp. 323, 329 (N.D. Ill. 1982), with those apparently allowing reference to extrinsic evidence, e.g., *People ex rel. Resnik v. Curtis & Davis, Architects & Planners, Inc.*, 78 Ill. 2d 381, 385, 400 N.E.2d 918, 919 (1980) (quoting *Carson Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 257-58, 178 N.E. 498, 501 (1931)) ("the intention is to be gleaned from a consideration of all the contract and the circumstances surrounding the parties at the time of its execution"). For seemingly conflicting statements within a single paragraph of an opinion, see *Illinois Housing Development Authority v. Sjoström & Sons, Inc.*, 105 Ill. App. 3d 247, 254-55, 433 N.E.2d 1350, 1356 (1982) ("intention is to be gleaned from a consideration of all of the contract provisions and the circumstances . . . [t]he liability of the promisor to the third party must affirmatively appear in the language of the contract [and] cannot be extended or enlarged on the sole ground that the situation and circumstances of the parties justify or demand further or other liability"). The Kansas, Louisiana, and North Carolina courts have made similar, apparently inconsistent statements about the use of extrinsic evidence. See *Martin v. Edwards*, 219 Kan. 466, 473-74, 548 P.2d 779, 785-86 (1976) (stating in one paragraph that the intent "must clearly be expressed in the contract" and in the next paragraph that "facts and circumstances surrounding execution become competent in the event the instrument is ambiguous"); *New Orleans Public Service, Inc. v. United Gas Pipe Line Co.*, 732 F.2d 452, 467-68, (5th Cir. 1984) (discussion of inconsistent statements and practice of the Louisiana courts); *CF Industries, Inc. v. Transcontinental Gas Pipe Line Corp.*, 448 F. Supp. 475, 479-480 (W.D.N.C. 1978), (discussion of inconsistent statements and practice of North Carolina courts).

<sup>52</sup> See, e.g., *Slate Printing Co. v. Metro Envelope Co.*, 532 F. Supp. 431, 433 (N.D. Ill. 1982); *Kaiser Aluminum & Chemical Corp. v. Ingersoll-Rand Co.*, 519 F. Supp. 60, 72-73 (S.D. Ga. 1981) (applying Georgia law); *Donalson v. Coca-Cola Co.*, 164 Ga. App. 712, 713, 298 S.E.2d 25, 27 (1982); *Alva v. Cloninger*, 51 N.C. App. 602, 607-09, 277 S.E.2d 535, 538-39 (1981); *Duncan-Lagnese and Associates, Inc. v. Stoney Creek Valley Sewer Authority*, 303 Pa. Super. 236, 241, 449 A.2d 666, 668 (1982); *General State Authority v. Sutter Corp.*, 44 Pa. Commw. 156, 165, 403 A.2d 1022, 1026-27 (1979).

<sup>53</sup> 666 F.2d 181 (5th Cir. 1982).

<sup>54</sup> The unusual facts of the case are found at 666 F.2d at 182-83. The plaintiff, the putative third party beneficiary, negotiated a sale of cotton to a Phillipine purchaser. The purchaser desired to complete the purchase through a United States government program which would provide immediate payment to the seller and would allow the purchaser three years to pay. As part of the program,

the requirement that evidence of the intent to benefit must appear in the contract.<sup>55</sup> Nevertheless, the Fifth Circuit did not cite such a requirement as part of Georgia law and found third party standing for the plaintiff even though a government agency, rather than the plaintiff, was listed as payee on the letter of credit. An injustice would certainly have occurred had standing been denied to the plaintiff because of an omission in the letter of credit when the intent to benefit him was so evident from the circumstances.<sup>56</sup>

Another case arguing against the propriety of the requirement of an express contract provision is *Kary v. Kary*.<sup>57</sup> In *Kary*, a decedent had entered into a contract to purchase land which provided that title should be given jointly to his brother and son.<sup>58</sup> The express terms seemed to provide that the brother was to benefit by gaining part ownership. An inquiry into the surrounding circumstances, however, revealed that the decedent had intended the brother only to assume a position of trust for the ultimate benefit of the decedent and his son.<sup>59</sup> Here the apparent express intent to benefit was negated by reference to the surrounding circumstances.

As these cases illustrate, the requirement that the evidence of intent be found in the express terms of the contract is an unreliable test<sup>60</sup> and ought to be rejected. Fortunately, many states either expressly allow reference to extrinsic evidence as a general matter<sup>61</sup> or permit reference to extrinsic evidence if the contract is not clear.<sup>62</sup> The remaining states simply fail to enunciate a rule so that use of extrinsic evidence may be fairly inferred to be permissible.

On balance, the courts have not been inclined to grant third party standing freely and in the most recent cases furnish no sign that this bias against third party standing is

the purchaser was required to obtain a letter of credit naming a United States government agency as payee; upon notice that the letter was effective the government would pay the plaintiff-seller. The defendant bank breached its obligations by failing to give notice that the letter of credit was effective and as a result the plaintiff was forced to sell the cotton at a price that was \$45,490 less than the contract price. Plaintiff then sued the bank for this amount, claiming to be a third party beneficiary of the letter of credit agreement between the purchaser and the bank even though the United States government agency was listed as the payee. The court found that circumstances showed "that the parties contemplated Beckman as an intended beneficiary of the contract."

<sup>55</sup> See *Backus v. Chilivis*, 236 Ga. 500, 502, 224 S.E.2d 370, 372 (1976); *Donalson v. Coca-Cola Co.*, 164 Ga. App. 712, 713, 298 S.E.2d 25, 27 (1982).

<sup>56</sup> The Court noted that the bank had sent a copy of the credit letter to the plaintiff and had equated "beneficiary" with the plaintiff as seller-exporter in its own letter of credit procedures. 666 F.2d at 183.

<sup>57</sup> 318 N.W.2d 334 (S.D. 1982).

<sup>58</sup> *Id.* at 335.

<sup>59</sup> *Id.* at 337.

<sup>60</sup> See Note, *Barriers to Recovery in Pennsylvania Third Party Beneficiary Law*, 82 DICK. L. REV. 143, 161 (1977) (discussing the unfairness of the Pennsylvania law requirement that the obligation to the beneficiary appear in the contract itself).

<sup>61</sup> See, e.g., *Just's, Inc. v. Arrington Construction Co., Inc.*, 99 Idaho 462, 464, 583 P.2d 997, 999 (1978); *Buchman Plumbing Co., Inc. v. Regents of the University of Minnesota*, 298 Minn. 328, 334, 215 N.W.2d 479, 483 (1974); *Kary v. Kary*, 318 N.W.2d 334, 336 (S.D. 1982); *Canipe v. National Loss Control Service Corp.*, 566 F. Supp. 521, 528-29 (N.D. Miss. 1983) (applying Tennessee law); *Suthers v. Booker Hospital District*, 543 S.W.2d 723, 727 (Tex. Civ. App. 1976); *Tracy Collins Bank & Trust v. Dickamore*, 652 P.2d 1314, 1315 (Utah 1982); *Simons v. Tri-State Construction Co.*, 33 Wash. App. 315, 323, 655 P.2d 703, 709 (1982).

<sup>62</sup> *Laclede Investment Corp. v. Kaiser*, 596 S.W.2d 36, 41 (Mo. Ct. App. 1980); *Broadway Maintenance Corp. v. Rutgers*, 90 N.J. 253, 260, 447 A.2d 906, 909 (1982); *Stodlar v. Hester*, 92 N.M. 26, 30, 582 P.2d 403, 407 (1978); *O'Connell v. Entertainment Enterprises, Inc.*, 317 N.W.2d 385, 388 (N.D. 1982).

changing. The propriety of this stance is questionable, however, particularly since a third party must still prove that a breach has occurred after standing is granted.<sup>63</sup> The more liberal granting of standing should have an unfavorable effect only on those promisors who fail to properly perform under their contracts. Third party beneficiaries seek no more than to have the promisor render the performance for which the promisor received consideration from the promisee.

### B. *The Parties' Intent*

Closely related to the question of what proof of intent is required to establish third party standing is the question of whose intent is required.<sup>64</sup> On this issue the different jurisdictions fall into three categories: jurisdictions which deem proof of the promisee's intent sufficient,<sup>65</sup> jurisdictions which require proof of the individual intent of both parties,<sup>66</sup> and those jurisdictions satisfied with proof that the promisor had reason to know of the promisee's intent to contract for third party rights.<sup>67</sup>

This aspect of third party beneficiary law has been the subject of some judicial and academic discussion. Those courts and commentators favoring a requirement of intent by the promisee alone generally follow the reasoning of Professor Corbin that since the promisee gives the consideration upon which the promise to benefit the third party is founded, the promisee's intent should govern.<sup>68</sup> This approach lends itself to easy application where the promisee's intent is clear but the contract and surrounding circumstances lack any express evidence of an affirmative intent on the part of the promisor to

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<sup>63</sup> See Jones, *supra* note 18, at 317-18. One of the factors causing courts to be restrictive in granting third party rights is a fear that contracting parties may be exposed to liability to an overly broad group of third persons. This fear appears unfounded in light of the "screening" devices, such as the need to prove a valid contract and a breach. *Id.* Of course, the basic screening device is that the parties may expressly deny third party beneficiary rights. See *Nepco Forged Products Inc. v. Consolidated Edison, Inc.*, 99 A.D.2d 508, 470 N.Y.S.2d 680, 681 (1984); *Broadway Maintenance Corp. v. Rutgers*, 90 N.J. 253, 260, 447 A.2d 906, 909 (1982).

<sup>64</sup> All states will normally speak of the "intent of the parties." The states mentioned in the ensuing categories go on to specify more exactly the intent required from the promisor or promisee. For the states which do not elaborate, the cases may be fairly read to require some intermediate showing of mutual intent that would fall between those states allowing that the intent of the promisee is most important and states requiring that the intent of both parties be manifest.

<sup>65</sup> See, e.g., *State v. Osborne*, 607 P.2d 369, 371 (Alaska 1980); *Stowe v. Smith*, 184 Conn. 194, 196 n.1, 441 A.2d 81, 83 n.1 (1981); *Khabbaz v. Swartz*, 319 N.W.2d 279, 285 n.9 (Iowa 1982); *Little v. Union Trust Co. of Maryland*, 45 Md. App. 178, 181, 412 A.2d 1251, 1253 (1980); *Goodman-Marks Associates v. Westbury Post Association*, 70 A.D.2d 145, 148, 420 N.Y.S.2d 26, 29 (1979); *ITT Industrial Credit Co. v. L.P. Gas Equipment, Inc.*, 453 F. Supp. 671, 675 (W.D. Okla. 1978) (applying Oklahoma law); *Kary v. Kary*, 318 N.W.2d 334, 336 (S.D. 1982).

<sup>66</sup> See, e.g., *American Financial Corp. v. Computer Sciences Corp.*, 558 F. Supp. 1182, 1185 (D. Del. 1983) (applying Delaware law); *L.D.H. Properties v. Morgan Trust Co.*, 145 Ga. App. 132, 133, 243 S.E.2d 278, 279-80 (1978); *Murphy v. Villanova Univ.*, 547 F. Supp. 512, 521 (E.D. Pa. 1982) (applying Pennsylvania law); *Clearwater Constructors, Inc. v. Gutierrez*, 626 S.W.2d 789, 791 (Tex. 1981); *Professional Realty Corp. v. Bender*, 216 Va. 737, 739; 222 S.E.2d 810, 812 (1976). See also *Williams v. Virgin Island Water & Power Authority*, 672 F.2d 1220, 1228 (3d Cir. 1982) (applying RESTATEMENT (SECOND) OF CONTRACTS § 302 and requiring that both parties' intent be present).

<sup>67</sup> See, e.g., *Zigas v. Superior Court*, 120 Cal. App. 3d 827, 838, 174 Cal. Rptr. 806, 811 (1981); *Tamposi Associates, Inc. v. Star Market Co., Inc.*, 119 N.H. 630, 633, 406 A.2d 132, 134 (1979); *Stollar v. Hester*, 92 N.M. 26, 30, 582 P.2d 403, 407 (1978).

<sup>68</sup> 4 A. CORBIN, CONTRACTS § 776 (1951).

benefit the third party. In these situations, jurisdictions that require only the promisee's intent have no problem recognizing standing for the third party.<sup>69</sup>

In jurisdictions that require an actual showing of individual intent by both parties, the situation described in the preceding paragraph results in a denial of third party standing because evidence of intent of the promisor is absent. The requirement that both parties must intend a benefit is usually coupled with a requirement that the intent expressly appear in the contract.<sup>70</sup> This combination of requirements may result in a premature termination of consideration of third party claims by the courts.<sup>71</sup> In such circumstances, finding no evidence of the promisor's intent in the contract terms, courts typically fail to go on to consider whether the contract, as read in the light of contracting circumstances, would support a conclusion that the parties actually intended to confer rights upon the third party or whether inferring such rights would be reasonable and consistent with the contracting parties' purposes.

Again, as with the rule requiring that evidence of intent be found in the contract itself,<sup>72</sup> only a minority of states require that a showing of intent by both parties be expressed in the contract. Most states either require only a showing of the promisee's intent or a showing that the promisor had reason to know of the promisee's intent. Of the three approaches, the latter one is preferable, since it requires both that some intent to benefit be attributable to the promisee and that this intent be ascertainable. Under this approach the intent of the promisee must be sufficiently obvious that the promisor must either have known or have had reason to know that he was assuming an obligation that might be enforced by the third party.

Although, as a practical matter, the "promisee's intent only" and the "promisee's intent plus promisor's recognition" rules would probably achieve the same result in most cases,<sup>73</sup> the latter phrasing offers two significant advantages. First, it addresses the fundamental concern of some courts that the promisor ought not to be burdened with greater obligations than those for which he contracted. Second, procedurally, it steers the court toward a more balanced and complete consideration of what intent as to the third party is fairly attributable to both of the contracting parties. This approach safeguards

<sup>69</sup> Cases may exist in which the promisor would be the only or primary party interested in conferring a benefit upon the third party. An example would be divorce settlement agreements which provide special support for children of the marriage. See cases cited *infra* notes 146-52. In these cases that intent of the promisor ought to be enough but, as a practical matter, the agreements probably would be construed to reflect an intent by both parties to confer a benefit.

<sup>70</sup> See *American Financial Corp. v. Computer Sciences Corp.*, 558 F. Supp. 1182, 1185-86 (D. Del. 1983); *Donalson v. Coca-Cola Co.*, 164 Ga. App. 712, 713, 298 S.E.2d 25, 27 (1982); *Pennsylvania Liquor Control Board v. Rapistan, Inc.*, 472 Pa. 36, 44, 371 A.2d 178, 181-82 (1976).

<sup>71</sup> See *Williams v. V.I. Water and Power*, 672 F.2d 1220, 1228 (3d Cir. 1982); *Hillbrook Apartments, Inc. v. Nyce Crete Co.*, 237 Pa. Super. 565, 571-72, 352 A.2d 148, 151-52 (1975).

<sup>72</sup> See *supra* notes 44, 50-60 and accompanying text.

<sup>73</sup> If a state strictly required only intent of the promisee and allowed that intent to be proven entirely by extrinsic evidence that the promisor may not have known about, then such a test might result in third party rights arising in a case where the promisor would not be chargeable with knowledge of the intent to benefit. For example, imagine that A contracts with B for B to cut and make into firewood the trees located on lot X. Unknown to B is that C owns lot X and A has promised C that the trees will be removed. Under a strict "promisee's intent only" rule, C would probably have standing to enforce the agreement against B. As the "promisee's intent only" rule is applied, however, this result is unlikely because the promisee's intent would have to be shown at least by some objective evidence in the contracting circumstances if not in the contract itself. See *Chmielecki v. City Products Corp.*, 660 S.W. 2d 275 (Mo. Ct. App. 1983) (prospective sublessee, intended to benefit by lessee but not revealed in any way to lessor-owner, could not be third party beneficiary).

against courts prematurely ending an evaluation of a contract and its surrounding circumstances after simply concluding that the promisee intended to benefit the third party. Requiring that, at a minimum, the promisor have reason to know of the promisee's intent to benefit the third party should force the courts to view the apparent intent of the promisee as the promisor would have viewed it — in the light of the circumstances in which the contract was made. Courts, therefore, would also be guided toward a more enlightened rule as to the role of extrinsic evidence.

### C. *The Intent Standard*

The courts have phrased the standard of intent that must be shown to confer rights upon a third party in different ways. The various formulations contain a rather consistent requirement of intent to confer a "direct" benefit or obligation.<sup>74</sup> This phrasing of the test for sufficient intent reflects once more the restrictive or conservative concerns of most courts in this area.<sup>75</sup> The requirement of direct benefit, however, is much more defensible than the restrictive rules requiring that intent appear in the contract or that both parties have an affirmative intent to benefit.

The requirement of "directness" reflects a definite consensus among courts that the distinction between enforceable and unenforceable third party rights depends on the quality and certainty of the benefit. This requirement also addresses much of the concern that the intent to benefit be sufficiently evident. For example, in the case of a true creditor beneficiary, where the promisor agrees to pay the promisee's debt to a third party, as found in the landmark case of *Lawrence v. Fox*,<sup>76</sup> the directness of the obligation from the promisor and of the benefit to the third party satisfies almost every element of the third party rules that has been raised so far. In the creditor beneficiary situation, the intent to benefit would be considered present in the express terms of the contract; any presumption against third party rights would be rebutted since the terms necessarily require a benefit to the third party;<sup>77</sup> and finally, the promisee would be deemed to have intended

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<sup>74</sup> See, e.g., *Group Health Inc. v. Schweiker*, 549 F. Supp. 135, 144 (S.D. Fla. 1982) (applying federal common law) ("must demonstrate that it was the intent and purpose of the contracting parties to confer a direct and substantial benefit"); *Taylor Woodrow Blitman Constr. Corp. v. Southfield Gardens Company*, 534 F. Supp. 340, 343 (D. Mass. 1982) ("It is well established under federal common law that one who is not a party to a contract may nevertheless have enforceable claims . . . if the contract was made for his direct benefit.") (footnote omitted); *Holley v. St. Paul Fire & Marine Ins. Co.*, 396 So. 2d 75, 80 (Ala. 1981) ("One who seeks recovery in contract as a third-party beneficiary must establish that the contract was intended for his direct, as opposed to incidental, benefit."); *Stowe v. Smith*, 184 Conn. 194, 196, 441 A.2d 81, 82-83 (1981) ("[T]he contracting parties intended that the promisor should assume a direct obligation to the third party."); *Mogensen v. Martz*, 441 N.E.2d 34, 35 (Ind. Ct. App. 1982) (performance of the terms must necessarily render "a direct benefit intended by the parties"); *Teter v. Morris*, 650 S.W.2d 277, 282 (Mo. Ct. App. 1982) (contract must be intended "for the direct benefit of the third party"); *Reidy v. Macauley*, 57 N.C. App. 184, 186, 290 S.E.2d 746, 747 (1982) ("[O]ur courts have consistently held that one may not maintain an action for breach of contract unless the contract was entered into for his or her direct benefit.").

<sup>75</sup> See *supra* note 45 and accompanying text.

<sup>76</sup> In *Lawrence v. Fox*, 20 N.Y. 268 (1859), A owed C \$300; A loaned B \$300 in exchange for a promise to repay the \$300 to C in satisfaction of A's indebtedness. C was found to be a creditor third party beneficiary of B's promise to A to pay the \$300 to C.

<sup>77</sup> In almost every state a party is considered to be third party beneficiary if he can satisfy the definition of a creditor beneficiary as described in the original Restatement Section 33, *supra* note 12, and the often cited 4 A. CORBIN, *CONTRACTS* § 774 (1951). Although the courts do not always expressly state it as such, a presumption is taken in favor of third party beneficiary standing if the

to benefit the third party, and the promisor would be fairly charged with sharing or recognizing that intent by the promisee.

It is noteworthy that the more direct the benefit to the third party and, correspondingly, the more direct the obligation assumed by the promisor, the more irrelevant becomes the question of whether the parties actually intended to confer rights or whether the court is filling a gap in the contract. As already suggested, the distinction between interpretation and gap-filling often becomes vague and tenuous — and perhaps valueless or impossible as a practical matter.<sup>78</sup> In instances, such as the true creditor beneficiary cases, where the benefit and performance is direct, courts need not and should not pursue the difficult search for subjective intent and may simply infer intent from the purpose of the contract as objectively manifested by the prescribed performances.

Acknowledging then that the requirement of direct benefit is a very effective test at least in the true creditor type of case, two questions arise: first, does the direct benefit standard lend itself to general application, and second, should third party rights be recognized in some instances when the benefit or obligation is something less than direct. These questions can be answered by surveying the decisions of the courts, which is the function of the second part of this article.<sup>79</sup>

Most courts have not applied a simple direct benefit test but instead have modified or supplemented it in ways that are not always helpful. Many courts have coupled their direct benefit requirement with a complementary requirement that the benefit not be incidental.<sup>80</sup> This contrast helps to identify the polar cases, that is, true creditor beneficiary arrangements as opposed to the true incidental beneficiary situations typified by

creditor definition can be deemed to apply. *See Jacobs Associates v. Argonaut Ins. Co.*, 282 Or. 551, 558, 580 P.2d 529, 532 (1978) (en banc) (when there is an express promise to pay the third party there need be no discussion of "intention to benefit"). In this case it would probably take an express or nearly express provision denying standing to prevent third party rights from arising. *See supra* note 63.

Some courts have also found a presumption in favor of third party beneficiary rights in other similar situations. *See, e.g., Jachim v. Coussens*, 88 Mich. App. 648, 653, 278 N.W.2d 708, 710 (1979) (applying statutory law: "A promise shall be construed to have been made for the benefit of a person whenever the promisor of said promise has undertaken to give or to do or refrain from doing something directly to or for said person." M.C.L. § 600.1405(1); M.S.A. § 27A.1405(1)). In this case, Firestone Tire and Rubber Company settled a lawsuit with the plaintiff's wife related to an accident resulting from a tire blowing out. As part of the settlement Firestone promised not to bring suit against the plaintiff unless certain conditions were met. When Firestone brought suit without the conditions being met, the plaintiff asserted an affirmative defense of release and settlement based on his status as a third party beneficiary of the settlement between Firestone and his wife. The court found that despite any subjective motives Firestone may have had, the plaintiff was a third party beneficiary because the "contract necessarily and directly" benefited him and because "parties are presumed to intend consequences of a performance of the contract." 88 Mich. App. at 654-55, 278 N.W.2d at 710.

For similar reasoning without statutory fortification see *Hialeah Hospital, Inc. v. Raventos*, 425 So. 2d 1205, 1206 (Fla. Dist. Ct. App. 1983); *Lipshie v. Tracy Investment Company*, 93 Nev. 370, 379, 566 P.2d 819, 825 (en banc) (1977); *Lonsdale v. Chesterfield*, 99 Wash. 2d 353, 360-62, 662 P.2d 385, 389-90 (1983).

<sup>78</sup> *See supra* note 48.

<sup>79</sup> *See text* accompanying notes 123-331.

<sup>80</sup> *See, e.g., Beverly v. Macy*, 702 F.2d 931, 940 (11th Cir. 1983); *Securities Fund Services Inc. v. American National Bank and Trust Co. of Chicago*, 542 F. Supp. 323, 329 (N.D. Ill. 1982); *Holley v. St. Paul Fire & Marine Ins. Co.*, 396 So. 2d 75, 80 (Ala. 1981); *Khabbaz v. Swartz*, 319 N.W.2d 279, 284 (Iowa 1982); *Martin v. Edwards*, 219 Kan. 466, 472-73, 548 P.2d 779, 785 (1976); *James v. State*, 90 A.D.2d 342, 457 N.Y.S.2d 148, 152 (1982).

illustration 11 to Section 133 of the original Restatement of Contracts.<sup>81</sup> In the latter category of cases the third person is not within the contemplation of the contracting parties and the benefit derived is not at all direct. This contrast of direct versus incidental benefit, however, is not particularly helpful in the majority of litigated cases which fall between the extremes. Rather, the distinction has only occasional value and is superfluous in most instances.

Other constructions of the direct benefit requirement, however, are entirely unhelpful. In West Virginia, for example, the courts have phrased the direct benefit test in terms of "sole benefit."<sup>82</sup> Using that formulation of the test, West Virginia courts have required that the contract be entered into for the sole and exclusive benefit of the third party.<sup>83</sup> This test is not only overly restrictive on its face, but, under close scrutiny, probably sets an impossible standard that would hardly be satisfied by even the true creditor beneficiary arrangement.<sup>84</sup> In fact, in the creditor beneficiary situation the debtor-promisor also will receive a substantial benefit from the payment by the promisor to the creditor-third party beneficiary that discharges the promisee's debt. Without such a benefit to the promisee, the contract would not be made.

Another potentially harmful construction of "direct" benefit is the requirement in several jurisdictions that the intent to benefit must be "primary" to be sufficiently direct.<sup>85</sup> In this context, "primary" could be deemed to require that the benefit to the third party be singularly primary or preeminent over any other benefit derived by other parties under the contract. "Primary," however, could also be construed to mean of sufficient, hierarchical importance to the contracting parties in contrast to goals or benefits of a secondary or less essential nature.<sup>86</sup> If the more restrictive definition first posited is

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<sup>81</sup> "B contracts with A to erect an expensive building on A's land. C's adjoining land would be enhanced in value by the performance of the contract. C is an incidental beneficiary." See *RESTATEMENT (SECOND) OF CONTRACTS* § 302, illustration 16 (1981).

<sup>82</sup> *Woodford v. Glenville State College Housing Corp.*, 225 S.E.2d 671, 674-75 (W. Va. 1976). ("[U]nder prior cases interpreting W. Va. Code, 55-8-12 [1923], this Court has held that in order for a contract concerning a third party to give rise to an independent cause of action in the third party, it must have been made for the third party's *sole* benefit.") (citations omitted) (emphasis added). *Id.* at 674. The code provision was enacted to reflect prior court decisions. *United Dispatch v. E.J. Albrecht Co.*, 135 W. Va. 34, 41, 62 S.E.2d 289, 294 (1950).

<sup>83</sup> See *United Dispatch v. E.J. Albrecht Co.*, 135 W. Va. 34, 41-46, 62 S.E.2d 289, 293-96 (1950).

<sup>84</sup> See *supra* note 76.

<sup>85</sup> See, e.g., *Norton v. First Federal Savings*, 128 Ariz. 176, 178, 624 P.2d 854, 856 (1981) (en banc) ("it must definitely appear that the parties intend to recognize the third party as the primary party in interest") (quoting *Irwin v. Murphey*, 81 Ariz. 148, 154, 302 P.2d 534, 538 (1956)); *Security Mutual Casualty Co. v. Pacura*, 402 So. 2d 1266, 1267 (Fla. Dist. Ct. App. 1981) ("that right is limited to those situations where the provisions of the contract clearly show an intention primarily and directly to benefit" the third party); *Canyon View Irrigation Company v. Twin Falls Canal Company*, 101 Idaho 604, 612, 619 P.2d 122, 130 (1980) ("it must be shown that the contract was made for his direct benefit, or as sometimes stated primarily for his benefit") (quoting *Dawson v. Eldredge*, 84 Idaho 337, 372, 414, 418 (1962)); *Weems v. Nanticoke Homes, Inc.*, 37 Md. App. 544, 553-54, 378 A.2d 190, 195 (1977) ("it must clearly appear that the parties intend to recognize him as the primary party in interest") (quoting *Mackubin v. Curtiss-Wright Corp.*, 190 Md. 52, 57-58, 57 A.2d 318, 321 (1948)); *Hines v. Amole*, 4 Ohio App. 3d 263, 268, 448 N.E.2d 473, 479 (1982) ("it must appear that the contract was made and entered into directly or primarily for the benefit of such third person") (citation omitted).

<sup>86</sup> A third possibility is that the term "primary" might be read to require that the particular provision have been inserted primarily for the benefit of the third person. See *Engle Acoustic & Tile Inc. v. Grenfell*, 223 So. 2d 613, 619 (Miss. 1969). This limit of the primary requirement to a provision as opposed to the whole contract might resolve some problems highlighted above but

accepted, the definition of "primary" involves problems similar to the "sole benefit" test discussed in the preceding paragraph.<sup>87</sup> Although "primary" in the sense of being singularly preeminent would allow for the possibility of other parties deriving a benefit, such a result would require a finding that the benefit to the third party was the most important reason for contracting. Measuring this standard against the true creditor beneficiary arrangement,<sup>88</sup> the intended benefit to the creditor-third party is not likely to be more important than the benefit the debtor-promisee hopes to derive for himself. Similarly, in other common cases where courts almost invariably grant third party standing, classifying the benefit to the third party as being of greater importance than other contracting goals is difficult.<sup>89</sup> Moreover, ranking the intended benefits often is likely to be a very difficult or even impossible exercise. If the less restrictive definition of "primary" is accepted, the primary benefit requirement may be used to distinguish a class of benefits as being of paramount importance.<sup>90</sup> In this usage, "primary" denotes a general distinction, as in the direct versus incidental benefit comparison, but offers no real help in making the finer distinctions often needed in third party beneficiary cases. Consequently the supplemental definition of "direct" as meaning "primary" is not helpful when used in this way.

Other variations of the requirement of a direct benefit are used.<sup>91</sup> The New York courts have phrased the test as requiring a direct benefit which is "sufficiently immediate";<sup>92</sup> the Michigan courts have required that the contract "necessarily" benefit the third party;<sup>93</sup> the Oklahoma courts have required that the direct benefit to the third party be "express" or "unmistakable";<sup>94</sup> and the courts of Utah have stated the test as requiring a

certainly not all. Further, the courts generally seem not to limit the term in this way. See cases cited *supra* note 85.

<sup>87</sup> See *supra* notes 82-84 and accompanying text. Some cases indeed seem to apply the "primary" benefit requirement in this manner. See *Orkin Exterminating Co., Inc. v. Robles*, 128 Ariz. 132, 134, 624 P.2d 329, 331 (Ariz. Ct. App. 1981); *Clearwater Key Association-South Beach, Inc. v. Thacker*, 431 So. 2d 641, 645 (Fla. Dist. Ct. App. 1983). The ultimate decisions in these cases were probably warranted but the application of the "primary" benefit standard in this manner sets an unhelpful precedent.

<sup>88</sup> See *supra* note 76.

<sup>89</sup> For example, consider construction contract surety cases in which laborers or suppliers are third party beneficiaries of express promises to pay those debts not satisfied by the contractor, but the owner receives a "primary" benefit through delivery of a lien-free building. See *infra* notes 257-65 and accompanying text.

<sup>90</sup> See *Canyon View Irrigation Co. v. Twin Falls Canal Co.*, 101 Idaho 604, 612, 619 P.2d 122, 130 (1980); *Schell v. Knickelbein*, 77 Wis. 2d 344, 348, 252 N.W.2d 921, 925 (1977).

<sup>91</sup> The variation allowing for "reliance" to be a factor is discussed *infra* notes 441-56 and accompanying text.

<sup>92</sup> See *New York State Energy Research & Development Authority v. Nuclear Fuel Services, Inc.*, 561 F. Supp. 954, 979 (W.D.N.Y. 1983).

<sup>93</sup> *Local 80 Sheet Metal Workers International Association, AFL-CIO v. Tishman Construction Corp.*, 103 Mich. App. 784, 789, 303 N.W.2d 893, 895 (1981); *Jachim v. Coussens*, 88 Mich. App. 648, 654, 278 N.W.2d 708, 710 (1979).

<sup>94</sup> *Keel v. Titan Construction Corp.*, 639 P.2d 1228, 1231 (Okla. 1982). On the Oklahoma construction of the direct benefit requirement, see also *Oil Capital Racing Association v. Tulsa Speedway*, 628 P.2d 1176, 1179 (Okla. Ct. App. 1981) (construing 15 OKLA. STAT. tit. 15, § 29 (1971): "A contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it."). The *Tulsa Speedway* Court stated:

The term "expressly" in a context relevant to this case means "directly" as distinguished from impliedly or indirectly. Thus the phrase "a contract, made expressly for the benefit of a third person" refers to a promise made directly for the third party's benefit.

The benefit cannot be enforced if it has to be implied from the terms of the contract or

benefit that is "separate and distinct."<sup>95</sup> Although these supplemental definitions may help in some cases, they all fail to offer a relatively hard but versatile measure of when a benefit is sufficiently "direct" or "necessarily" a part of the contract or so "immediate" as to satisfy the courts that it is proper to interpret or infer from the contract an intention to confer a right upon the third party. This deficiency is reflected in situations where the benefit "necessarily" results from performance or is more "immediate" than other possible benefits but would be deemed by almost every court to be unenforceable by the third party. A good example would be a profit producing contract of a partnership or corporation which necessarily benefits partners or stockholders in a relatively immediate manner but will not be judged to confer enforceable third party beneficiary rights upon them.<sup>96</sup>

#### D. *Categorization Test — Creditor, Donee and Incidental Beneficiaries*

A last but very significant standard for determining third party beneficiary standing is the categorization test embodied in Section 133 of the original Restatement of Contracts<sup>97</sup> and employed by many courts under the influence of Section 133 or the Corbin treatise,<sup>98</sup> or as a result of independent evolution. This method of determining third party rights apparently originated in early cases such as *Seaver v. Ransom*.<sup>99</sup> In that case the court recognized a categorization test limiting recovery to certain public contracts cases and to contracts benefiting wives, children, recipients of direct promises and creditors.<sup>100</sup> The court was willing to stretch the test to allow a favorite niece to recover on a contract promise made for her benefit upon consideration provided by her decedent aunt.<sup>101</sup> In

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results incidentally from its performance. The statute does not require the contract to expressly state that the beneficiary can enforce it, but only that the beneficial promise be express as it is here.

628 P.2d at 1179.

<sup>95</sup> *Rio Algom Corp. v. Jimco Ltd.*, 618 P.2d 497, 506 (Utah 1980).

<sup>96</sup> See *infra* notes 173-77 and accompanying text.

<sup>97</sup> See *supra* note 12 for text of RESTATEMENT OF CONTRACTS § 133.

<sup>98</sup> The Corbin formulation of the categorization test is nearly identical to the RESTATEMENT OF CONTRACTS § 133 and can be found at 4 A. CORBIN, CONTRACTS § 774 (1951).

<sup>99</sup> 224 N.Y. 233, 120 N.E. 639 (1918).

<sup>100</sup> *Id.* at 237-39, 120 N.E. at 640-41.

<sup>101</sup> The Court stated in part:

In New York the right of the beneficiary to sue on contracts made for his benefit is not clearly or simply defined. It is at present confined: First. To cases where there is a pecuniary obligation running from the promisee to the beneficiary, "a legal right founded upon some obligation of the promisee in the third party to adopt and claim the promise as made for his benefit." . . . Secondly. To cases where the contract is made for the benefit of the wife . . . affianced wife . . . or child . . . of a party to the contract. The close relationship cases go back to the early King's Bench case (1677), long since repudiated in England, of *Dutton v. Poole*, 2 Lev. 211 (s.c., 1 Ventris, 318, 332). . . . The natural and moral duty of the husband or parent to provide for the future of wife or child sustains the action on the contract made for their benefit. "This is the farthest the cases in this state have gone," says Cullen J., in the marriage settlement case of *Borland v. Welch*, 162 N.Y. 104, 110, 56 N.E. 556, 557 (1900).

The right of the third party is also upheld in, thirdly, the public contract cases . . . where the municipality seeks to protect its inhabitants by covenants for their benefit; and, fourthly, the cases where, at the request of a party to the contract, the promise runs directly to the beneficiary although he does not furnish the consideration. . . . It may be safely said that a general rule sustaining recovery at the suit of the third party would include but few classes of cases not included in these groups, either categorically or in principle.

reaching this result, the court underscored the primary problem with categorization tests, namely that such tests do not easily encompass all the diverse situations in which legitimate third party rights may accrue.

The currently predominant and nearly exclusive categorical ordering employed by the courts is that of creditor, donee and incidental beneficiaries. Those beneficiaries qualifying as creditors or donees are considered to have enforceable rights while all those not fitting into those two categories are deemed incidental beneficiaries and not sufficiently intended to benefit to have enforceable rights. The categorization method of determining standing suffers from two weaknesses. First, some *intended* beneficiaries may fall into a gap between the creditor and donee categories and be deemed incidental because the categorization test either is poorly stated or misapplied. Second, the test of a donee is often simply a search for sufficient indicia of intent to make a gift and therefore does not constitute a real improvement over the intent to benefit test, which the categorization device is meant to supplement.

A few courts have recognized the problems inherent in the categorization test and have deemphasized its importance, considering it to be a useful aid but not decisive in determining third party standing.<sup>102</sup> Many courts, however, continue to require that a third party qualify as a creditor or donee to have enforceable rights.<sup>103</sup>

The concern about improper formulation of the categorization test would not be significant for those courts adopting the definitions of creditor and donee provided in Section 133, since Section 133 was designed to avoid any "gap" into which some intended beneficiaries might fall.<sup>104</sup> For those jurisdictions not adopting the creditor and donee definitions from Section 133, however, the danger of gap cases is more real. In Tennessee, for example, courts seem simply to classify the beneficiary as a donee where a "purpose to make a gift" is present and as a creditor where the performance "will satisfy an actual or supposed asserted duty."<sup>105</sup> The danger in this sort of simplistic creditor and donee definition is that a party may intend to confer a right where no duty, actual or supposed, is asserted and where the circumstances do not supply any evidence of a familial or otherwise altruistic motive for the making of a gift. A good example is found in *Vikingstad v. Baggott*.<sup>106</sup> In that case the seller in a real estate contract promised to the

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The desire of the childless aunt to make provision for a beloved and favorite niece differs imperceptibly in law or in equity from the moral duty of the parent to make testamentary provision for a child. The contract was made for the plaintiff's benefit. She alone is substantially damaged by its breach. The representatives of the wife's estate have no interest in enforcing it specifically.

224 N.Y. at 237-39, 120 N.E. at 640-41.

<sup>102</sup> See *Broadway Maintenance Corp. v. Rutgers*, 90 N.J. 253, 260, 447 A.2d 906, 909 (1982); *Kemp v. Hudnall*, 423 So. 2d 1260, 1262 (La. Ct. App. 1982).

<sup>103</sup> See, e.g., *Williams v. Fenix & Scisson, Inc.*, 608 F.2d 1205, 1208 (9th Cir. 1979) (applying federal common law); *King v. National Industries, Inc.*, 512 F.2d 29, 33 (6th Cir. 1975) (applying Kentucky law); *New Hampshire Ins. Co. v. City of Madera*, 144 Cal. App. 3d 298, 308, 192 Cal. Rptr. 548, 554 (1983); *Khabbaz v. Swartz*, 319 N.W.2d 279, 284 (Iowa 1982); *Martin v. Edwards*, 219 Kan. 466, 472-73, 548 P.2d 779, 785 (1976); *Weems v. Nanticoke Homes, Inc.*, 37 Md. App. 544, 553, 378 A.2d 190, 195 (1977); *Hardware Center, Inc. v. Parkedge Corp.*, 618 S.W.2d 689, 693 (Mo. Ct. App. 1981); *Carolina Builders Corp. v. AAA Dry Wall, Inc.*, 43 N.C. App. 444, 447, 259 S.E.2d 364, 366-67 (1979); *Mary Ellen Sandlie Trust v. Pioneer National Title Ins. Co.*, 648 S.W.2d 761, 762 (Tex. Civ. App. 1983).

<sup>104</sup> See *infra* note 110 and accompanying text.

<sup>105</sup> *McCall v. Towne Square, Inc.*, 503 S.W.2d 180, 184 (Tenn. 1973).

<sup>106</sup> 46 Wash. 2d 494, 282 P.2d 824 (1955).

purchaser that he would return to a third party the money deposit the third party had made under a prior purchase contract for the same parcel of land. There was no reason to believe the subsequent purchaser either owed a duty to the third party or had any apparent desire to make a gift to benefit him.<sup>107</sup> In all likelihood the subsequent purchaser simply sought to defuse any potential action by the third party that might create a cloud over his title to the land. While the intent to confer a direct benefit was clear, the third party in *Vikingstad v. Baggott* would not clearly fall into the simplistic creditor or donee categories.

Fortunately, most courts<sup>108</sup> using the creditor and donee categories as a test for intent do so with reference to the formulation of Section 133 of the Restatement (First) of Contracts or similar statements.<sup>109</sup> In those formulations the creditor category is given an expansive definition to include any party to whom the promisee may owe an actual, supposed, asserted, or even legally barred duty. The donee class is given an even more expansive definition that includes not only those for whom an apparent, true donative intent to make a gift is present but also any others to whom an intent to confer a right against the promisor exists. These formulations should not allow any gap between the creditor and donee categories into which an otherwise intended beneficiary could fall.<sup>110</sup>

Despite the safeguards of the Section 133 formulation, on occasion the courts either improperly allow intended beneficiaries to fall into a gap when they should not or prematurely cease the search for intent because of a prima facie failure by the claimant to qualify as a creditor or donee. *King v. National Industries, Inc.*,<sup>111</sup> is such a case. *King* involved a bankruptcy trustee's challenge to settlement of a claim that a debtor-subsidary corporation held against the defendant-parent corporation.<sup>112</sup> The underlying contract was an agreement between the parent corporation and a purchaser of stock in the subsidiary providing that the parent corporation would guarantee a promissory note in favor of the subsidiary.<sup>113</sup> When the maker of the note defaulted and judgment proved uncollectible, the parent became liable to the subsidiary because of its promise to the purchaser to guarantee the note.<sup>114</sup> In resolving the legitimacy of a subsequent settlement agreement between the three parties, the court concluded that the subsidiary was neither a creditor nor donee beneficiary of the promise to guarantee the debt it was owed.<sup>115</sup> While the purchaser owed no duty to the subsidiary which would be satisfied by the promise of the parent to guarantee the note, the purchaser sought to make the parent liable on the note to the subsidiary. This case appears to reflect an instance of a promisee's intent to confer a right upon the third party against the promisor. Yet the Sixth Circuit panel concluded that the subsidiary was not a donee beneficiary because there was no intent "to make a gift."<sup>116</sup> Consequently, in the opinion of the court, the subsidiary,

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<sup>107</sup> *Id.* at 495-97, 282 P.2d at 825-26.

<sup>108</sup> See cases cited *supra* note 103.

<sup>109</sup> See text of § 133 *supra* note 12.

<sup>110</sup> As thus defined both the creditor and donee categories are broader than the labels would suggest, and the donee category was designed to include *all* proper beneficiaries who are not creditor types.

<sup>111</sup> 512 F.2d 29 (6th Cir. 1975).

<sup>112</sup> *Id.* at 30-31.

<sup>113</sup> *Id.* at 30.

<sup>114</sup> *Id.* at 30-31.

<sup>115</sup> *Id.* at 32-33.

<sup>116</sup> The Sixth Circuit panel decided that Kentucky law properly applied to the case and that the state law required that a contract must be "made and entered into directly or primarily for the

qualifying as neither creditor nor donee beneficiary, was necessarily an incidental beneficiary and had no claim under the guarantee of the note.<sup>117</sup> Similar misapplications of the creditor and donee categorization test resulting in an improper denial of standing can be found in other cases.<sup>118</sup>

Most courts manage to avoid the "gap" problem that arises from either improper formulation or erroneous application of the categorization test for intent. Another deficiency exists, however, in the categorization test. While the test works well in straightforward creditor beneficiary cases, it often offers little help in cases involving supposed donee beneficiaries. This deficiency arises because classification as a creditor primarily depends on the objective finding of a creditor-debtor or similar relationship between the promisee and a third party. In other words, if the promisee owes a debt or is otherwise actually, supposedly, or allegedly obligated to the third party, the potential exists for the promisor to promise to discharge the obligation and consequently create third party rights. In some cases a somewhat subjective question may remain about whether the promisor and promisee intended to create a direct obligation in the promisor to the third party. The objective determination of whether the creditor relationship exists, however, will serve as a fundamental qualifier and, if found, should create a presumption in favor of third party beneficiary status that helps resolve any subjective question.<sup>119</sup>

In contrast, the donee beneficiary class, as defined in Section 133, does not contain the element of an objectively provable relationship that limits potential claimants or creates a presumption of third party rights when found present. While familial relation-

benefit" of a third person before he would have rights. 512 F.2d at 32. In further construing the Kentucky rule, the Court stated that:

The only third parties having such rights are donee beneficiaries and creditor beneficiaries. One is a donee beneficiary if the purpose of the promisee in buying the promise is to make a gift to the beneficiary. A person is a creditor beneficiary if the promisee's expressed intent is that the third party is to receive the performance of the contract in satisfaction of an actual or supposed duty or liability of the promisee to the beneficiary. Any others who may incidentally benefit from a contract are no more than incidental beneficiaries with no enforceable rights under the contract. *See generally* 4 A. CORBIN, CONTRACTS § 779C at 40-41 (1951), 2 S. WILLISTON, CONTRACTS § 356 at 824-27 (3d ed. 1959), RESTATEMENT OF CONTRACTS § 133 at 151-52 (1932).

Plaintiff has argued that [the subsidiary] may properly be considered a donee beneficiary. Plaintiff has not, however, pointed to any indication that the promisee, [the purchaser], intended to make a gift to [the subsidiary] or that the 1966 contract was made for [the subsidiary's] benefit. Without such a showing, Kentucky law does not permit [the subsidiary] to sue on the contract. . . . Neither has there been any showing that performance of the promise would satisfy any real or asserted duty of the promisee to [the subsidiary] so as to make [the subsidiary] a creditor beneficiary. We therefore conclude that [the subsidiary] was not a third-party beneficiary under the 1966 agreement and that it had no enforceable rights under it.

*Id.* at 33 (footnote omitted) (citations to Kentucky law omitted) (emphasis added).

<sup>117</sup> *Id.* For a case with similar facts reaching a different and more reasonable conclusion, see *Vickers v. First Mississippi National Bank*, 458 So. 2d 1055, 1062 (Miss. 1984) (corporation was third party beneficiary of agreement between new majority stockholder, former stockholders and bank which provided that bank would make financing available to the corporation).

<sup>118</sup> *See infra* note 122.

<sup>119</sup> *See, e.g.,* *Lipshie v. Tracy Investment Co.*, 93 Nev. 370, 379, 566 P.2d 819, 825 (1977) ("A contract to pay a debt to a third person is presumed for his benefit unless it appears that the contract was not so intended.") (citations omitted); *Jacobs Associates v. Argonaut Ins. Co.*, 282 Or. 551, 558, 580 P.2d 529, 532 (1978) (en banc) (when an express promise to pay a third party has been found the subjective intent of the promisee is immaterial).

ships and other similar contexts suggesting a basis for some altruistic motive on the part of the promisee may aid in classifying a beneficiary as a donee,<sup>120</sup> the class is much broader.<sup>121</sup> Just as every contract potentially benefits some third parties, all those third parties may lay claim to donee beneficiary status without showing any particular relationship to the promisee. Most donee beneficiary cases then revolve entirely around a search for the rather subjective "intent to make a gift to or confer a right" upon the third party. Classification as a donee is the equivalent of simply answering the basic question whether third party rights were intended. The difficult search for evidence of intent to benefit remains central to delimiting the broad donee class, and the categorization test helps very little, if at all.<sup>122</sup>

## II. CURRENT TRENDS IN APPLICATION OF THIRD PARTY BENEFICIARY RULES

One may properly conclude from the foregoing survey and discussion that the judicial standards currently used in determining third party beneficiary rights suffer from significant flaws and are susceptible to improvement. Despite the undeniable difficulties present in the various formulations, they are still capable of yielding decisions that reveal trends or areas of consistency that may be instructive in ascertaining the optimal construction of Section 302 of the Restatement (Second) of Contracts. Moreover, identifying areas where the courts seem to reach inconsistent results may also aid in framing an efficient rule, particularly if one outcome can be determined to be a "better" result<sup>123</sup> and the new rule is construed to yield that outcome.

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<sup>120</sup> The existence of a familial relationship does seem to make it easier for courts to find a donee beneficiary and the requisite intent, *see infra* notes 140-52 and accompanying text, but the courts generally have not indicated as a clear presumption in favor of third party rights in these cases as is found in the true creditor beneficiary cases. *But see* *Saylor v. Saylor*, 389 S.W.2d 904 (Ky. 1965) (rebuttable presumption of intent to create third party right exists where husband opened joint savings account in wife's name).

<sup>121</sup> *See* RESTATEMENT OF CONTRACTS § 133, *supra* note 12, and *supra* notes 109-10 and accompanying text. The donee class is a "catchall" class encompassing all intended beneficiaries who are not creditor types.

<sup>122</sup> Among the difficult donee cases is *Lewis v. Globe Construction Co., Inc.*, 6 Kan. App. 2d 478, 630 P.2d 179 (1981). The State contracted with the defendant to make highway improvements in Wichita. The contract provided that the work would be done in a manner that "maintain[ed] local traffic to the businesses between Hillside and Harry [Streets]." Upon failure to keep traffic open, business owners brought suit against the contractor as third party beneficiaries of the State-contractor agreement. The court found that the access provision of the contract did not reflect any "clear intent to benefit any particular person or business" and that the business owners were "neither 'donee' nor 'creditor' beneficiaries." *Id.* at 486, 630 P.2d at 184. The contract also contained an express provision negating any third party rights, but the court seemed to rest its decision as well on the failure to satisfy the categorization test. *Id.* at 486, 630 P.2d at 184-85.

In *McKinney v. Davis*, 84 N.M. 352, 503 P.2d 332 (1972), an injured employee was found not to be a third party beneficiary of an employer-government contract which provided in part, "[t]o protect the [employer], he must carry workman's liability and compensation insurance on all labor employed under this agreement." The court found it "clear" that the employee was not a creditor beneficiary and also found that he was not a donee beneficiary because the contract terms did give the employer reason to know that the promisee held a purpose to confer a benefit upon the employee. *Id.* at 354, 503 P.2d at 334.

<sup>123</sup> A "better" result would be one that would be logically consistent with outcomes in similar types of cases and one that would thereby aid in establishing clear standards for third party beneficiary determinations to be applied not only to the common cases but also in the more unique situations, such as those set out in notes 1-9, *supra*.

Courts have reached a consensus on some "easy" cases in third party beneficiary law. Typical examples are contracts containing rather straightforward promises by one party to pay a debt owed by the promisee to the third party<sup>124</sup> as well as cases where fairly clear intent to make a gift to the third party through the promised performance is present.<sup>125</sup> Consistent trends can also be identified in other cases such as cases involving contracts for the drafting of wills, contracts of employers which may benefit employees, and contracts of corporations or partnerships which may benefit the shareholders or partners. Areas in which the courts have achieved less of a consensus include contracts involving government and public services, construction contracts, and real estate transactions. This part of the article contains a survey and discussion of these types of cases.

*A. Promises to Pay a Debt or Satisfy an Obligation*

Cases still arise concerning the promise of a promisor to pay a debt owed by the promisee to a third party as was the situation in *Lawrence v. Fox*.<sup>126</sup> These cases are easy for the courts when the promise to pay or assumption of obligation is clear. An example is found in the Florida case of *Hialeah Hospital Inc. v. Raventos*,<sup>127</sup> involving a contract for the division and sale of a business. As part of the sale agreement, the parties agreed to divide and assume the obligations of the former business entity. The Florida District Court of Appeals concluded that the sale agreement included an express promise to pay a third party and that in such a case the intent to benefit should be presumed.<sup>128</sup> The Massachusetts case of *Choate, Hall & Stewart v. SCA Service, Inc.*<sup>129</sup> also involved a rather straightforward promise to pay a debt. In that case the defendant corporation obligated itself in a settlement agreement with a former employee to pay all his legal costs resulting from lawsuits related to his past employment. The court decided that there was an express promise to pay a third party and that this promise created rights in the plaintiff who served as counsel for the former employee.<sup>130</sup>

Cases involving clear assumptions of obligations other than money debts are equally easy for the courts and are exemplified by cases such as *Southwick v. Ace Auto Body Shop, Inc.*<sup>131</sup> In that case the defendant promised the plaintiff's insurer to repair the plaintiff's insured automobile. The Missouri Court of Appeals had no difficulty in concluding that the insured was a third party beneficiary of the contract to make repairs and did not need

<sup>124</sup> See *infra* notes 126-30 and accompanying text.

<sup>125</sup> Although establishing a group to be called "true donee beneficiary" cases would be difficult, a consensus of jurisdictions could certainly be achieved upon some types of donee cases, for example, family based transactions as found in *Seaver v. Ransom*, 224 N.Y. 223, 120 N.E. 639 (1918), or cases cited *infra* notes 140-52.

<sup>126</sup> 20 N.Y. 268 (1859). See *supra* note 76.

<sup>127</sup> 425 So. 2d 1205 (Fla. Dist. Ct. App. 1983).

<sup>128</sup> *Id.* at 1206. *Accord* Spiklevitz v. Markmil Corp., 136 Mich. App. 587, 592, 357 N.W.2d 721, 724 (1984).

<sup>129</sup> 378 Mass. 535, 392 N.E.2d 1045 (1979). See *supra* note 26.

<sup>130</sup> *Choate, Hall & Stewart v. SCA Service, Inc.*, 378 Mass. at 546-48, 392 N.E.2d at 1052. The Court was faced with less than perfectly clear language but concluded that:

[T]he parties agreed that payments under the clause would be made "directly" to [the promisee's] counsel. . . . If payments were to be made to [the promisee], performance by the defendant would not discharge [the promisee's] obligation to the plaintiff; the contrary is true when payments are to be made direct to the plaintiff, and it becomes very plausible to allow the plaintiff his action against the defendant.

*Id.* at 547, 392 N.E.2d at 1052.

<sup>131</sup> 646 S.W.2d 401 (Mo. Ct. App. 1983).

to embark upon a search for the often elusive intent of the contracting parties.<sup>132</sup> Similarly, in the case of *McCall v. Towne Square*,<sup>133</sup> the Tennessee Supreme Court easily concluded that third party rights existed where the defendant, a construction company, promised the purchaser of realty lots to build an office building for the plaintiff-seller of the lots. The seller had agreed to accept the construction of the office building as compensation for the lots and was thus a third party beneficiary of the construction contract.<sup>134</sup>

Caution should be exercised in determining whether in fact a promise to pay a debt or assume an obligation exists in cases of this kind. In the case of *House of Falcon, Inc. v. Gonzalez*,<sup>135</sup> the contracting parties agreed upon a division of liability for debts in connection with the sale of a music publishing business. The plaintiff-third party held a royalty claim against the former business which was barred by the statute of limitations. The Texas Court of Civil Appeals concluded that no third party rights were created in the absence of an express promise to pay which would also serve to revive the time barred debt.<sup>136</sup> According to the court, the contracting parties had promised to pay and had created third party rights in only those creditors with valid debts. Other cases exist in which contracting parties entered into agreements concerning debts owed to third parties, and perhaps even contemplated their payment, but did not include an ascertainable promise to pay. Third party beneficiary rights were therefore denied.<sup>137</sup>

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<sup>132</sup> *Id.* at 403. See also *Abney v. Allstate Insurance Co.*, 442 So. 2d 590, 591 (La. Ct. App. 1983) (insured homeowner was third party beneficiary of contract between insurer and contractor to repair fire damage to home).

<sup>133</sup> 503 S.W.2d 180 (Tenn. 1973).

<sup>134</sup> *Id.* at 183-84. "In the instant case, M&M [the plaintiff] falls into the second of the three aforementioned classes [creditor beneficiary]. This necessarily follows because Towne Square was clearly under a duty to construct the commercial building for M&M and Bob Smith Construction Co. promised to perform that duty." *Id.* at 184. See also *Julian Johnson Construction Corp. v. Parranto*, 352 N.W.2d 808, 811 (Minn. Ct. App. 1984) (developer was third party beneficiary of contract between township and contractor for construction of roads that township was obligated to provide by agreement with developers).

<sup>135</sup> 583 S.W.2d 902 (Tex. Civ. App. 1979).

<sup>136</sup> *Id.* at 906. The relevant portion of the contract was a promise that "[s]ellers agree to be responsible . . . for all royalties owing to composers, publishers and/or publishers' agents under mechanical licenses, and does hereby agree to indemnify and hold buyers harmless from any liability . . . that accrued prior to October 24, 1970." *Id.* at 904. The royalties sought by the alleged third party beneficiary were barred by the statute of limitations and the court found this language insufficient to revive the debt or to create a new obligation to pay as a third party beneficiary. *Id.* at 905-06.

<sup>137</sup> See, e.g., *O'Connell v. Entertainment Enterprises, Inc.*, 317 N.W.2d 385 (N.D. 1982). When the employer failed financially, its creditor and a nearby hotel entered into an agreement to assume the management of the business. The agreement provided that the creditor would have the capacity to retire debts. The employee, who was owed nearly \$15,000 in back salary, sought payment as third party beneficiary of the debt retirement provision. The court concluded that the debt retirement provision was included so that the parties could continue operating the business as usual but that "[n]either First Federal nor Erin Hotels, in either of the written contracts, agreed to assume prior obligations of Entertainment Enterprises. Although some of the prior debts may have been paid by First Federal or Erin Hotels, neither was obligated to do so under the written contracts." *Id.* at 389. (emphasis added). See also *Duncan-Lagnese and Associates, Inc. v. Stoney Creek Valley Sewer Auth.*, 303 Pa. Super. 236, 241, 449 A.2d 666, 668 (1982) (contracts prepared in connection with acquisition of loan indicated the loan was obtained to meet obligations under agreement with engineers and others working on construction project but this circumstance did not reflect an intent to confer a third party right upon the engineer); *Choate, Hall & Stewart v. SCA Services Inc.*, 378 Mass. 535, 546-48, 392 N.E.2d 1045, 1052 (1979) (discussion concerning need for express promise to pay third party).

From the foregoing discussion it may be concluded that when the promisor promises to pay a debt or assume an obligation owed by the promisee to a third party the courts will determine that the third party has the right to enforce the promise without any requirement of a showing that the contracting parties actually contemplated enforcement by the third party. In this true creditor beneficiary type of case courts will presume the intent to create rights in a third party, unless an express contractual provision<sup>138</sup> or patently clear circumstances indicate a contrary intention.<sup>139</sup> This presumption of intent is consistent with those versions of the intent test focusing on a "direct" obligation or benefit. In this type of case the performance and benefit go directly from the promisor to the third party; the promisee whose debt or obligation is relieved when the third party is satisfied has a less direct or derivative benefit. This aspect of the relatively easy, true creditor beneficiary cases should be contrasted with other more difficult cases which lack this component of directness.

#### B. Gift Cases — Including Divorce Settlement Agreements

Some donee beneficiary cases are comparable to the cases discussed in the foregoing section and, as in the creditor situation, courts have little difficulty in finding the requisite intent for recognition of third party rights. The case of a husband who deposits money into a savings account to be held jointly with his wife is an example. Considering this type of situation in *Saylor v. Saylor*,<sup>140</sup> the Kentucky Court of Appeals concluded that the wife was a third party beneficiary of the deposit agreement which allowed the wife access to the funds. More particularly, the court concluded that the nature of the joint savings account raised a presumption of intent to create rights in the third party.<sup>141</sup> The particular aspect of this type of account on which the court focused was essentially a promise by the bank-depository to pay the funds to the wife as joint holder.<sup>142</sup> Such a promise is quite similar to the promise of the promisor in the true creditor beneficiary type of case.

Other more recent cases have involved promises similar to the promise in *Saylor v. Saylor* and courts deciding those cases have required direct benefit or performance in the nature of a gift. Situations involved include an agreement that a bank draw certificates of deposit so that upon the death of the depositor the certificates would pass to her niece,<sup>143</sup> a

<sup>138</sup> Express provisions denying third party beneficiary rights will be honored even when the contract otherwise indicates third party rights. See *supra* note 63.

<sup>139</sup> See, e.g., *Jett v. Phillips & Associates*, 439 F.2d 987, 991 (10th Cir. 1971). The creditor-payee on a promissory note was found not to be a third party beneficiary of a promise to guarantee the note where the circumstances indicated that the purpose in making the guarantee was to share liability with original obligors on the note but not to benefit the payee. The court apparently was convinced that the circumstances negated a direct obligation despite the apparent direct, certain benefit to the payee.

<sup>140</sup> 389 S.W.2d 904 (Ky. 1965).

<sup>141</sup> *Id.* at 906. The court stated:

By his deposit of money a contract was created between Mr. Saylor and the bank. By causing the account to be established and maintained in the names of himself and his wife, in the absence of evidence of the contrary there is a rebuttable presumption that Mr. Saylor intended to and did make his wife a third party beneficiary of the contract.

<sup>142</sup> *Id.* The court stated that the proper inference is that either party named on the account may demand money from the account and the bank would be obligated to comply. See also *Vaughn v. Perkins*, 576 S.W.2d 257, 261 (Ky. Ct. App. 1979) (husband's making of joint checking account and certificates of deposit in the name of himself and wife made her a third party beneficiary).

<sup>143</sup> *Baker v. Bank of Northeast Arkansas*, 271 Ark. 948, 951, 611 S.W.2d 783, 874 (Ark. App. 1981); accord *Malek v. Patten*, — Mont. —, 678 P.2d 201 (1984).

promise by a vendor to a vendee to execute a deed in favor of a third party upon the vendee's death,<sup>144</sup> and a promise by a promoter of stock car races to the county race track owner to pay the participating car drivers a percentage of gate receipts.<sup>145</sup>

Similar issues have arisen in the context of divorce settlement agreements involving a promise by one parent to another to provide some support or benefit to their children.<sup>146</sup> The courts of the several jurisdictions that have considered the question have concluded that third party rights in the child arise when there is a promise to pay the child's college education expenses,<sup>147</sup> to name the child as beneficiary of an insurance policy,<sup>148</sup> to establish a trust account for the benefit of the child,<sup>149</sup> or to write a will to benefit a child.<sup>150</sup> The courts have generally rejected, however, attempts by children to collect on a promise by the absent parent to make basic child support payments to the parent with custody.<sup>151</sup> An established line of New York decisions holds that suits by a child for basic support payments are improper unless the guardian-parent is unable or unwilling for some reason to assert the right to payment. The reasoning, in part, is that while the basic support payments are undeniably for the benefit of the child, the parties and society contemplate enforcement solely by the parent with custody.<sup>152</sup>

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<sup>144</sup> *Marosites v. Proctor*, 59 N.C. App. 353, 354, 296 S.E.2d 526, 526 (1983). The court found that a third party beneficiary contract could be used to pass property upon death or promise without conflict with laws governing wills and probate. *Id.* at 354, 296 S.E.2d at 527.

<sup>145</sup> *Oil Capital Racing Association v. Tulsa Speedway*, 628 P.2d 1176, 1178 (Okla. Ct. App. 1981).

<sup>146</sup> For two cases not involving children, see *In re Spong*, 661 F.2d 6, 10 (2d Cir. 1981) (wife's attorney was third party beneficiary of divorce settlement provision requiring that husband pay her attorney's fees) and *Costanza v. Costanza*, 346 So. 2d 1133, 1135 (Ala. 1977) (bank holding invalid mortgage was not third party beneficiary of divorce property settlement agreement which provided, in part, that mortgaged property would be sold and proceeds used to satisfy the invalid mortgage — leaving open the possibility that if the mortgage had been valid the bank would have been a creditor-type third party beneficiary).

<sup>147</sup> See *Mitchell v. Combank/Winter Park*, 429 So. 2d 1319, 1322 (Fla. Dist. Ct. App. 1983); *Stegall v. Stegall*, 571 S.W.2d 564, 566 (Tex. Civ. App. 1978).

<sup>148</sup> See *Orsini v. Commercial National Bank*, 639 S.W.2d 516, 518 (Ark. Ct. App. 1982); *In re Estate of Lemer*, 306 N.W.2d 244, 246 (S.D. 1981).

<sup>149</sup> See *McDaniel Title Co. v. Lemons*, 626 S.W.2d 686, 690 (Mo. Ct. App. 1981); *Stebbins v. Stebbins*, 121 N.H. 1060, 1064, 438 A.2d 295, 298 (1981). See also *Thorpe v. Collins*, 245 Ga. 77, 263 S.E.2d 115 (1980) (father of child born out of wedlock denied summary judgment against claim that child was third party beneficiary of agreement with mother for father to establish trust and write will to benefit child).

<sup>150</sup> See *In re Estate of Lingle*, 72 N.J. 87, 95, 367 A.2d 878, 882 (1976); *Kuhn v. Kuhn*, 281 N.W.2d 230, 236 (N.D. 1979); accord *In re Estate of Gosmire*, 331 N.W.2d 562, 568 (S.D. 1983) (agreement between two brothers that one's will would devise property to the other's son).

<sup>151</sup> See *Cronebaugh v. VanDyke*, 415 So. 2d 738, 742 (Fla. Dist. Ct. App. 1982); *Drake v. Drake*, 89 A.D.2d 207, 209-10, 455 N.Y.S.2d 420, 422 (1982).

<sup>152</sup> *Drake v. Drake*, 89 A.D.2d 207, 210-11, 455 N.Y.S.2d 420, 423 (1982) and cases cited therein. The *Drake* court stated:

From this may be distilled a simply stated general rule in New York that barring unusual circumstances, children have no standing to enforce the periodic support provisions of their parents' separation agreement although they may enforce other specific provisions of the agreement clearly made for their exclusive benefit, such as a promise to pay college tuition or to make the child a beneficiary of a life insurance policy. The distinction drawn comports with the rules of law applicable to third party beneficiaries and further is rooted in considerations of public policy designed to promote familial harmony and foster the parent-child relationship. A parent's contrac-

In support of the distinction between the child support cases and those cases involving benefits beyond basic child support, it should be noted that the former involve a direct performance not to the child but to the custodial parent. Nothing in a typical divorce settlement suggests that child support payments should be made directly to the child. On the other hand, the proceeds from an insurance policy, the benefits of a trust agreement, or the payment of the child's education cost need not be made to a custodial parent. These benefits are normally paid directly to the child after reaching majority or otherwise reaching emancipation. The key to a finding of third party rights in these divorce settlement cases, as in the true creditor and gift beneficiary cases, is the presence of a promise to give a direct benefit or performance to the third party.

### C. *Contracts to Draft Wills*

Since the 1961 decision of the California Supreme Court in *Lucas v. Hamm*<sup>153</sup> recognized the right of an intended legatee to bring suit against an attorney who failed to properly draft a will pursuant to a contract for services with the testator, the courts of several other jurisdictions have similarly been confronted with the question of whether such suits state a valid claim under contract or tort theory or both.<sup>154</sup> The courts have reached a nearly unanimous, albeit uneasy, conclusion that a cause of action in contract ought to be recognized.<sup>155</sup> The basis for these claims is that the persons to whom the testator desires to leave bequests are the intended beneficiaries of a contract between the testator and the attorney for the drafting of a will.<sup>156</sup> If the attorney should fail to properly draft the will and cause a bequest to fail, the intended legatee is deemed to have third party standing to enforce the contract for the drafting of the will.

This particular type of third party contract action raises some special issues. Recognizing a cause of action in cases of this kind, at least to some degree, runs counter to the established policy that the professional services of an attorney ought to be specifically tailored to the needs of the client, without fear of lawsuits by third parties.<sup>157</sup> Moreover, in these cases mistakes may lay hidden for many years before being discovered upon the

tual promise to pay child support is made with a view toward his statutory duty of support.

*Id.* at 212, 455 N.Y.S.2d at 424. The court earlier identified the unusual circumstances that might allow a child standing as possibly the "disability of one kind or another of one spouse to enforce his own legal rights." *Id.* at 211, 455 N.Y.S.2d at 423.

<sup>153</sup> 56 Cal. 2d 583, 15 Cal. Rptr. 821 (1961).

<sup>154</sup> See *Needham v. Hamilton*, 459 A.2d 1060, 1062 (D.C. 1983) and cases cited therein.

<sup>155</sup> Courts recently allowing suit by the intended legatee against the attorney on a third party beneficiary theory include: *Garcia v. Borelli*, 129 Cal. App. 3d 24, 180 Cal. Rptr. 768 (1982); *Stowe v. Smith*, 184 Conn. 194, 441 A.2d 811 (1980); *DeMaris v. Asti*, 426 So. 2d 1153 (Fla. Dist. Ct. App. 1983); *Ogle v. Fuiten*, 112 Ill. App. 3d 1048, 445 N.E.2d 1344 (1983); *Millwright v. Romer*, 322 N.W.2d 30 (Iowa 1982); *Guy v. Liederbach*, 501 Pa. 47, 459 A.2d 744 (1983).

The court in *Needham v. Hamilton*, 459 A.2d 1060 (D.C. 1983), chose not to recognize a third party beneficiary contract action on the reasoning that the malpractice cause of action was better suited to limit the class of third parties to which the attorney would be potentially liable. *Id.* at 1062-63.

<sup>156</sup> See *Guy v. Liederbach*, 501 Pa. 47, 59, 459 A.2d 744, 750 (1983): "The fact that the beneficiary is named in the will is not relevant to third party status [sic]. The will is not the contract but rather that which is contracted for."

<sup>157</sup> See *Needham v. Hamilton*, 459 A.2d 1060, 1061-62 (D.C. 1983); *Guy v. Liederbach*, 501 Pa. 47, 62-63, 459 A.2d 744, 752-53 (1983).

death of the testator.<sup>158</sup> While the attorney whose error is discovered after a long period of time is no less at fault than the attorney whose mistake is quickly discovered, the serious possibility of errors surfacing decades after performance does cause some instinctive concern.<sup>159</sup> Furthermore, the attorney's liability to an intended legatee is potentially larger than his liability to the testator if the breach is discovered before the testator's death. The testator would arguably be entitled to specific performance or damages in the form of either restitution of fees paid for preparation of the incorrectly drawn will or the cost of having the will revised to effect the testator's wishes.<sup>160</sup> The damages to be collected by the intended legatee could be much larger if the intended bequest is substantial and is rendered ineffective through the attorney's error. Since the only logical remedy available to third party beneficiaries is money damages to satisfy the expectancy loss,<sup>161</sup> the attorney could be required to make redress for the portion of the testator's estate which became misdirected. This outcome may appear harsh but denying a cause of action to the intended legatee may prevent any remedy for the attorney's breach. The estate may either be unable or unwilling to enforce the contract to draft the will and even if it did sue on the contract, damages for the estate probably would be nominal.<sup>162</sup>

Apart from the policy concerns outlined in the preceding paragraph, this type of action may be analyzed under the test of direct benefit or performance. In performing a contract to draft a will, the attorney-promisor renders the performance directly to the testator-promisee. The direct benefit is also arguably received by the testator, who is satisfied by the prospect that his estate will pass according to his desires. The benefit to the intended legatees, on the contrary, is contingent, subject to the testator's ability to revoke the will. Only upon the death of the testator will the benefit to the legatees become immediate and necessary. This category of cases, therefore, probably qualifies as one in which neither the performance nor the benefit flows directly to the third party, even though the ultimate benefit may be substantial.

Allowing third party standing in cases of this kind not only seems inconsistent with the direct performance or benefit test but also is not supported by an argument that attorneys contracting to draft a will would be likely to intend to assume a direct liability to the intended legatees, or even that the testator would seek to extract such a promise.

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<sup>158</sup> In *Guy v. Liederbach*, the will was drafted on February 24, 1957, the testator died on October 12, 1972 (15 years and nearly 8 months later), and the law suit against the attorney began on January 23, 1976 (nearly 19 years later). 501 P.2d at 52-53, 459 A.2d at 747.

<sup>159</sup> The possibility that a claim may lie dormant for decades would raise the same questions of unfairness that serve as justification for statutes of limitations and the doctrine of laches. Evidence may be lost or interested parties may die. See 5A A. CORBIN, CONTRACTS § 1167.

<sup>160</sup> This outcome would probably be obtained under normal contract principles since the testator would have suffered no greater damages than those flowing from having the will improperly drawn. At any time before the death of the testator he could have the will rewritten to accomplish the desired distribution of the estate. See *Guy v. Liederbach*, 501 Pa. 47, 65, 459 A.2d 744, 754 (1983) (Roberts, C.J., dissenting).

<sup>161</sup> In *Guy v. Liederbach* the Pennsylvania Supreme Court majority opinion stated that the measure of an intended legatee's damages is her loss of expectancy. 501 P.2d at 62, 459 A.2d at 752. It is difficult to perceive that any other measure of money or equitable damages could apply.

<sup>162</sup> Specific performance is not a feasible remedy since the testator is deceased and cannot execute a new will. The money damages to the estate would probably be limited to nominal damages or restitution of money paid to the attorney since the estate has not lost money as a result of the breach; only the intended legatee has experienced an expectancy loss. Further, even if the estate could sue for the benefit of the intended legatee, other heirs to the estate could challenge this spending of the assets since it would not bring any benefit to the estate itself.

Considering, however, the likelihood that the testator's estate will be unable or unwilling to seek enforcement of a contract to draft a will, the courts seem inclined to prefer allowing the intended legatee to pursue a third party beneficiary action rather than permitting the attorney's breach to go without sanction.<sup>163</sup>

#### D. *Employees, Shareholders and Partners*

Employees have largely been unsuccessful when they have sought third party standing on their employers' contracts, except when the employers have contracted with an employees' union or some other party expressly for the direct benefit of the employees.<sup>164</sup> The cases in which employees were denied third party standing largely fall into three categories: cases in which the employer loses a contract with another party and the employee seeks to recover against the other party for loss of the opportunity to work;<sup>165</sup> cases in which another party contracts to provide some service to the employer which affects the work of the employees and fails to perform the service;<sup>166</sup> and cases in which

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<sup>163</sup> One might suppose that a preferable solution would be a moderating change in the probate laws to permit the devise of property according to a testator's wishes despite technical flaws in the execution of the will. But in light of the current exact requirements of probate law, the lesser evil may well be to allow suit by the legatee rather than permit the attorney's breach to go unredressed.

It is worth remembering in this context that the legatee must prove a breach by the attorney and that if the alleged mistake does not constitute an actionable breach then the attorney may yet avoid liability.

<sup>164</sup> Employees are considered to be third party beneficiaries of contracts between employers and employee unions. See *Mohr v. Metro East Mfg. Co.*, 711 F.2d 69, 72 (7th Cir. 1983); *Wilks v. American Bakeries Co.*, 563 F. Supp. 560, 562 (W.D.N.C. 1983) (citing Section 301 of Labor Management Relations Act of 1947, 29 U.S.C. § 185 (1976)). Employees also may recover as third party beneficiaries when promises are made that expressly provide for a direct performance or benefit. See *Northwestern National Bank of Minneapolis v. Williamson*, 545 F.2d 76, 80 (8th Cir. 1976) (employees were found to be third party beneficiaries of contract provision governing pension continuation in the sale of the employer's business); *Lange v. Consolidated Rail Corp.*, 575 F. Supp. 371, 372-73 (N.D. Ohio 1983) (employee was third party beneficiary of contract between employer and real estate agency which provided, in part, that the real estate agency would offer to buy the homes of transferred employees at fair market value); *Farris v. General Growth Development Corp.*, 354 N.W.2d 251, 254-55 (Iowa Ct. App. 1984) (employee of subcontractor was third party beneficiary of contract between owner and general contractor that expressly required general contractor to implement safety procedures for those working on construction site).

<sup>165</sup> See, e.g., *Group Health, Inc. v. Schweiker*, 549 F. Supp. 135, 144 (S.D. Fla. 1982) (employees unsuccessfully sought standing as third party beneficiaries of a terminated contract between the employer and federal government for the employer to act as provider of medicare services); *State v. Osborne*, 607 P.2d 369, 371 (Alaska 1980) (employees were found not to be third party beneficiaries of employer-house builder's contract with vendor to build a house).

<sup>166</sup> See, e.g., *Wallace v. Texaco, Inc.*, 681 F.2d 1088, 1090 (5th Cir. 1982) (employee injured during onsite transport was not a third party beneficiary of contract between employer-contractor and defendant to provide transportation); *Canipe v. National Loss Control Service Corp.*, 566 F. Supp. 521, 528-29 (N.D. Miss. 1983) (injured employee was not third party beneficiary of contract between employer and defendant requiring defendant to conduct safety and hazard inspections); *Gonzales v. Kil Nam Chun*, 465 N.E.2d 727, 729 (Ind. Ct. App. 1984) (injured employee determined not to be third party beneficiary of contract between employer and defendant for the provision of scaffolding by defendant which collapsed during use); *Paradiso v. Apex Investigators & Security Co. Inc.*, 91 A.D.2d 929, 929, 458 N.Y.S.2d 234, 235 (1983) (employee injured in armed robbery was not a third party beneficiary of contract between employer and defendant for security guard services). See also *Campbell v. Continental-Emsco Co.*, 445 So. 2d 70, 73 (La. Ct. App. 1984) (decedent employee was not third party beneficiary of employer's agreement with insurance agent to obtain liability insurance for business that should have covered fatal accident).

the employer promises the other contracting party to do some act which would appear to benefit the employees and fails to properly perform.<sup>167</sup>

The case of *Paradiso v. Apex Investigators & Security Co., Inc.*<sup>168</sup> succinctly presents the recurring grounds for denial of third party standing in these cases. In *Paradiso* the plaintiff was the employee of a supermarket and was injured during an armed robbery. The plaintiff brought suit against the company providing security guards to the supermarket for breach of the contract to provide effective security services. In an extremely brief memorandum opinion, the majority of the court<sup>169</sup> concluded that it did not "clearly appear" from the contract provisions that the parties intended to benefit the plaintiff by protecting him from physical injury.<sup>170</sup> The appellate court granted summary judgment as a matter of law without considering whether in fact the contract had been breached in a manner which caused the injury.

In a case such as *Paradiso*, employees would necessarily benefit from the effective provision of security services. What seems really to be decisive in cases of this kind, however, is the view of the courts that a direct benefit is also received by the employer and that the primary purpose in contracting is to benefit the employer, not the employees.<sup>171</sup> Consequently, the benefit to the employees is essentially derivative from the benefit to the employer. This ranking of benefits causes courts to deny employees third party beneficiary standing even though the potential benefit involved may be substantial. A very good case could be made under the facts of *Paradiso*, however, that the employer is benefited only to the extent that injury to property and persons is avoided by effective security services. In this sense the employer is the party who derives an indirect benefit from the more direct benefit to the employee. This view, however, has not yet attracted a following.<sup>172</sup>

Shareholders in corporations and members of partnerships, like employees, have received unwelcome treatment when attempting to enforce the contracts of the corporate

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<sup>167</sup> See, e.g., *Davis v. United Air Lines, Inc.*, 575 F. Supp. 677, 680 (E.D.N.Y. 1983) (discharged handicapped employee did not have cause of action on third party beneficiary theory by virtue of employer's contract with government requiring affirmative action for the handicapped); *McKinney v. Davis*, 84 N.M. 352, 354, 503 P.2d 332, 334 (1972) (employee was not third party beneficiary of employer's contract with government requiring the employer to obtain workers' compensation insurance); *Clearwater Construction Co. v. Gutierrez*, 626 S.W.2d 789, 791 (Tex. Civ. App. 1981) (decedent employee and wife were not third party beneficiaries of provision in contract between employer and U.S. Corps of Engineers which required employer to implement safety controls).

<sup>168</sup> 91 A.D.2d 929, 458 N.Y.S.2d 234 (1983).

<sup>169</sup> The court was divided 4-1 with the dissenting judge filing a separate opinion.

<sup>170</sup> 91 A.D.2d at 929, 458 N.Y.S.2d at 235 (quoting *Bernal v. Pinkerton's Inc.*, 52 A.D.2d 760, 382 N.Y.S.2d 769, *aff'd*, 41 N.Y.2d 938, 394 N.Y.S.2d 638 (1976)).

<sup>171</sup> The court in *State v. Osborne*, 607 P.2d 369 (Alaska 1980), reasoned that the employer-house builder did not enter into contracts to build homes to benefit the employee by creating employment. 607 P.2d at 371. This reasoning is quite solid but does not necessarily carry over to cases involving the provision of security or safety services on a job site. For a case with facts similar to *Paradiso* in which the employee was more properly an incidental beneficiary, see *Bizien v. Port Authority of States of New York and New Jersey*, 578 F. Supp. 1093 (E.D.N.Y. 1983). The contract in that case expressly stated that the security service was to protect property rather than employees. *Id.* at 1102. The guards were strictly limited to duties not including the protection of employees or other persons. *Id.* at 1101.

<sup>172</sup> Another possible way of viewing these cases is that the store may have an obligation to provide security for persons on the premises and may contract with the security company to assume that obligation, thereby creating third party beneficiary rights for employees or patrons on premises. See *Brown v. National Supermarkets, Inc.*, 679 S.W.2d 307, 309-10 (Mo. Ct. App. 1984).

or partnership entities.<sup>173</sup> In these kinds of cases, as with employees, the putative third party beneficiaries are nearly certain to benefit from the profitable contracts of their organizations, but their benefit is distinguished from the more direct benefit to the organization itself. The Massachusetts Appeals Court, for example, in *First Hartford Realty Corp. v. Corporate Property Investors*<sup>174</sup> considered an action by a former general partner upon a contract between the partnership and another party. The court concluded that the general partner was no more than an incidental beneficiary even though "[t]he flow of funds to the partnership would have redounded to the significant financial benefit of [the general partner]."<sup>175</sup> The court reasoned that the general partner was in that respect "like a shareholder, who may not claim to be a third party beneficiary of a contract made on behalf of the corporation in which he owns stock."<sup>176</sup> Other courts agree that, in the absence of an express intent to benefit the shareholders, the benefit is not sufficiently "direct" to support third party standing.<sup>177</sup>

E. *Government and Public Service Contracts — Including Low-Income Housing Tenant Cases*

Under the influence of cases such as *H. R. Moch Co. v. Rensselaer Water Co.*<sup>178</sup> and the first Restatement of Contracts Section 145,<sup>179</sup> third party beneficiary rights under gov-

<sup>173</sup> See cases cited *infra* note 177.

<sup>174</sup> Mass. App. Ct. Adv. Sh. 1389 (July 17, 1981), 423 N.E.2d 1020 (1981) (applying New York law).

<sup>175</sup> *Id.* at 1390, 423 N.E.2d at 1022.

<sup>176</sup> *Id.* at 1390, 423 N.E.2d at 1021.

<sup>177</sup> See, e.g., *Brooks v. Land Drilling Co.*, 564 F. Supp. 1518, 1520-21 (D. Colo. 1983) (stock purchasers were not third party beneficiaries of merger contract between issuer company and another); *Jacobs v. Pabst Brewing Co.*, 549 F. Supp. 1050, 1067 (D. Del. 1982) (shareholders were not third party beneficiaries of contract between corporation and its investment counselors); *Donalson v. Coca-Cola Co.*, 164 Ga. App. 712, 713, 298 S.E.2d 25, 27 (1982) (majority stockholder was not third party beneficiary of contract between issuer and another corporation for services); *Canyon View Irrigation Co. v. Twin Falls Canal Co.*, 101 Idaho 604, 613, 619 P.2d 122, 131 (1980) (shareholder-users of irrigation company system were not third party beneficiaries of contract allowing company the right to expand).

<sup>178</sup> 247 N.Y. 160, 159 N.E. 896 (1928). The *Moch* case involved a lawsuit by a plaintiff whose warehouse was destroyed by fire. The action was brought against the defendant water company on the theory that the plaintiff was a third party beneficiary of the contract between the water company and the city government for the provision of water to five hydrants; the plaintiff alleged that the contract was breached in that the water pressure in the hydrants was insufficient to allow proper extinguishment of the fire. Justice Cardozo, writing for the court, concluded that although all city contracts benefit the public, more must be shown to give rise to individual third party rights. *Id.* at 164, 159 N.E. at 898.

<sup>179</sup> The text of the section reads:

§ 145. Beneficiaries Under Promises to the United States, a State, or a Municipality.

A promisor bound to the United States or to a State or municipality by contract to do an act or render a service to some or all of the members of the public, is subject to no duty under the contract to such members to give compensation for the injurious consequences of performing or attempting to perform it, or of failing to do so, unless,

- (a) an intention is manifested in the contract, as interpreted in the light of the circumstances surrounding its formation, that the promisor shall compensate members of the public for such injurious consequences, or
- (b) the promisor's contract is with a municipality to render services the non-performance of which would subject the municipality to a duty to pay damages to those injured thereby.

The comparable section of the Restatement (Second) of Contracts is Section 313. The section has been changed to establish clearly that the general rules of third party beneficiary law should apply to

ernment contracts have often been afforded a different treatment. Simply stated, the courts have required that a more express indication of intent to assume liability to third parties be present in certain contracts made with a governmental entity as promisee.<sup>180</sup> The distinction, however, has not always been properly observed between government contracts for a public service, which warrant application of the different rule, and those of a more private nature which do not involve the rendition of services to the general public. The case of *Visintine & Co. v. New York, Chicago & St. Louis R. Co.*<sup>181</sup> is a good example of the latter situation. *Visintine* involved a government contract with a construction company requiring preparatory work for the benefit of another company participating in the construction of a railroad grading. *Moch v. Rensselaer*,<sup>182</sup> involving the rendition of water supply services throughout a community to all residents, stands as an example of a public service contract. Some government contracts, however, fall between these categories. Such cases typically involve what may be described as "hybrid" transactions involving either public services of a limited scope or a mixture of general public benefits and specific effects on a relatively limited group.<sup>183</sup>

The presumption against third party rights arising out of contracts with the government should properly be limited to those contracts of a true public service nature. Recent examples include contracts involving the provision of water to hydrants or fire fighting

government contracts but then preserves, essentially, the provisions of Section 145. See RESTATEMENT (SECOND) OF CONTRACTS § 313, Reporter's Note (1981); 44 American Law Institute [hereinafter referenced as ALI] Proceedings 331-33 (1967) (comments of reporter on revised Section 145 during drafting of the Restatement (Second)). The text of Section 313 of the Restatement (Second) reads:

§ 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.

(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.

<sup>180</sup> See, e.g., *Dateline Builders, Inc. v. City of Santa Rosa*, 146 Cal. App. 3d 520, \_\_\_, 194 Cal. Rptr. 258, 263 (1983); *Kornblut v. Chevron Oil Co.*, 62 A.D.2d 831, 834-35, 407 N.Y.S.2d 498, 501 (1978), *aff'd*, 48 N.Y.2d 853, 424 N.Y.S.2d 429 (1979); see also E. FARNSWORTH, CONTRACTS § 10.4 (1982).

<sup>181</sup> 169 Ohio St. 505, 160 N.E.2d 311 (1959).

<sup>182</sup> 247 N.Y. 160, 159 N.E. 896 (1928). See *supra* note 178.

<sup>183</sup> Examples of this "hybrid" type of transaction include: a contract between the government and an employer requiring affirmative action for handicapped employees, see *Howard v. Uniroyal, Inc.*, 719 F.2d 1552, 1555 (11th Cir. 1983); *Chaplin v. Consolidated Edison Co. of N.Y.*, 579 F. Supp. 1470, 1471 (S.D.N.Y. 1984); *Davis v. United Airlines, Inc.*, 575 F. Supp. 677, 679-80 (E.D.N.Y. 1983); an agreement to provide relief services to refugees as a specific group, see *Nguyen v. U.S. Catholic Conference*, 548 F. Supp. 1333, 1348 (W.D. Pa. 1982); agreements between the federal government and railroad corporations requiring affirmative action for minority owned businesses in awarding contracts for supplies and services, see *Organization of Minority Vendors v. Illinois Central Gulf R.R.*, 579 F. Supp. 574, 600-01 (N.D. Ill. 1983); a road construction contract requiring that public have continued access to those specific businesses in the area, see *Lewis v. Globe Construction Co., Inc.*, 6 Kan. App. 2d 478, 486, 630 P.2d 179, 185-86 (1981); a contract to administer a work/study student financial aid program, see *Murphy v. Villanova University*, 547 F. Supp. 512, 521 (E.D. Pa. 1982).

services,<sup>184</sup> the provision of airport services to the general public,<sup>185</sup> the supply of utilities to city agencies for redistribution to consumers,<sup>186</sup> and the provision of public transportation.<sup>187</sup> The factors present in *Moch v. Rensselaer* tend to justify a hesitance to recognize third party rights in these cases. Such factors are the threat of liability to extremely large numbers of third parties, the absence of any pre-existing duty on the government to provide the services contracted for, and the absence of a likelihood that the contracting parties would have sought or intended to impose an obligation on the promisor which could be enforced by the third parties.<sup>188</sup>

These considerations do not suggest that in true public service contracts the contracting government entities did not intend to provide benefits to the public. When a city negotiates a no-strike agreement with transportation unions the agreement is undoubtedly for the purpose of providing continuous transportation services to the public and promoting the general welfare of the city and its inhabitants. The factors listed in the preceding paragraph,<sup>189</sup> however, suggest that while such benefits are certainly intended, and not truly incidental, the contracting parties would not have contemplated, or intended if they had considered it, that individual members of the public have standing to sue for breach.

This presumption against third party rights should not be applied to those contracts of a government entity that are essentially of a private nature, such as the contract involved in *Visintine*. An extreme example of a government contract of a private nature is found in the Illinois case of *Redarowicz v. Ohlendorf*.<sup>190</sup> In that case a city entered into an agreement with a building contractor in which the city agreed to forego legal action based

<sup>184</sup> See *New Hampshire Ins. Co. v. City of Madera*, 144 Cal. App. 3d 298, 308, 192 Cal. Rptr. 548, 554 (1983) (citizen whose commercial building was destroyed by fire sought third party beneficiary standing on contract between city and county for latter to provide fire fighting aid in city fires); *Harris v. Board of Water and Sewer Commissioners*, 294 Ala. 606, 611, 320 So. 2d 624, 628 (1975) (citizen whose restaurant was destroyed by fire sought third party beneficiary standing on contract between city and board of water and sewer commissioners for latter to provide water to hydrants which were discovered to be dry during the fire).

<sup>185</sup> See *Santa Monica Airport Association v. City of Santa Monica*, 481 F. Supp. 927, 946 (C.D. Cal. 1979), *aff'd.*, 659 F.2d 100 (9th Cir. 1981) (association of pilots sought third party standing on grant agreement between city and Federal Aviation Administration providing for public use of airport).

<sup>186</sup> See *New Orleans Public Service, Inc. v. United Gas Pipe Line Co.*, 690 F.2d 1203, 1211-12, *modified*, 694 F.2d 421 (5th Cir. 1982) (consumers sought third party beneficiary standing on rate contract between public utility and wholesaler of natural gas); see also *County of Suffolk v. Long Island Lighting Co.*, 554 F. Supp. 399, 409 (E.D.N.Y. 1983) (county and resident consumers sought third party beneficiary standing on agreement between federal agency and utility governing construction of a nuclear power station). *But see Koch v. Consolidated Edison Company of New York, Inc.*, 62 N.Y.2d 548, 558-59, 468 N.E.2d 1, 6-7 (1984) (plaintiffs — city and public benefit corporations who purchased electricity from state power authority were third party beneficiaries of contract between power authority and defendant utility for transmission and delivery of electricity to the plaintiffs).

<sup>187</sup> See *Burns, Jackson, Miller, Summit & Spitzer v. Lindner*, 88 A.D.2d 50, 74-75, 452 N.Y.S.2d 80, 94-95 (1982), *aff'd.*, 59 N.Y.2d 314, 451 N.E.2d 459, 464 N.Y.S.2d 712 (1983); *Burke & Thomas, Inc. v. International Organization of Masters*, 92 Wash. 2d 762, 767-68, 600 P.2d 1282, 1285-86 (1979) (businesses sought third party beneficiary standing on contract between municipal transit authorities and transit union providing that there would be no strikes by the union).

<sup>188</sup> See *Moch v. Rensselaer*, 247 N.Y. 160, 165-66, 159 N.E. 896, 897-98 (1928). See also RESTATEMENT (SECOND) OF CONTRACTS § 313, Comment a (1981).

<sup>189</sup> See *supra* note 188 and accompanying text.

<sup>190</sup> 92 Ill. 2d 171, 441 N.E.2d 324 (1982).

on building code violations in exchange for a promise to make repairs to the plaintiff's home.<sup>191</sup> In this case there was a reasonable basis for assuming that the contracting parties might have agreed to allow the homeowner to enforce directly the contract, if that contingency had been contemplated, because, as in *Visintine*, no large class of potential third party beneficiaries existed and no advantage in allowing the city to control litigation was apparent.<sup>192</sup>

While courts have little difficulty in deciding cases involving clear public service obligations or obligations of an obviously private nature, cases involving "hybrid" types of government contracts<sup>193</sup> have often proved difficult for the courts. These limited public service cases have generated several noteworthy decisions, including the *Martinez v. Socoma Companies, Inc.*<sup>194</sup> case in California. The *Martinez* case grew out of a federal government effort to alleviate widespread unemployment and other related problems through a program providing financial support and incentives to private industry to employ the "hard-core unemployed."<sup>195</sup> The defendants entered into contracts with the federal government which provided that the defendants would receive monetary compensation in exchange for investing money in the renovation of building facilities, training and employing for at least 12 months a specified number of "certified" disadvantaged residents of the East Los Angeles neighborhood, and for providing those employees with opportunities for advancement and stock purchases in the employer corporation.<sup>196</sup> The defendant companies received money from the federal government pursuant to the contracts but largely failed to employ any of the residents.<sup>197</sup>

Members of a limited class of East Los Angeles residents, who were certified as disadvantaged and therefore eligible for employment under the contracts,<sup>198</sup> brought an action against the defendant companies on a contract third party beneficiary theory. The California Supreme Court denied standing to the plaintiff class in a four to three decision.

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<sup>191</sup> *Id.* at 179, 441 N.E.2d at 327-28. Addressing the specific question of whether the owner was an intended beneficiary the court stated:

The agreement between the city and the defendant specifically enumerates the repairs that are to be undertaken at the plaintiff's home. As a third party to the agreement it is intended that benefits accrue directly to the plaintiff through performance of the contract. Because the identification of the plaintiff as a direct beneficiary is clear, and the intent of the parties to the agreement is unmistakable in indicating as much, the plaintiff is permitted to maintain an action as a third party beneficiary. (citations omitted).

*Id.*

<sup>192</sup> See also *CF Industries v. Transcontinental Gas Pipe Line Corp.*, 448 F. Supp. at 479-80 (based upon allegations, if proven, purchaser of natural gas would be third party beneficiary of contract between public utility and gas wholesaler for additional supply of gas to be sold specifically to this purchaser).

<sup>193</sup> See *supra* note 183 and accompanying text.

<sup>194</sup> 11 Cal. 3d 394, 521 P.2d 841, 113 Cal. Rptr. 585 (1974).

<sup>195</sup> *Id.* at 398, 521 P.2d at 843, 113 Cal. Rptr. at 587. The program was established pursuant to 1967 amendments to the Economic Opportunity Act of 1964, 81 Stat. 688-690, 42 U.S.C. §§ 2763-2768, repealed by 86 Stat. 703 (1972).

<sup>196</sup> *Martinez v. Socoma Companies, Inc.*, 11 Cal. 3d 394, 398, 521 P.2d 841, 843, 113 Cal. Rptr. 585, 587 (1974).

<sup>197</sup> *Id.* at 400, 521 P.2d at 845, 113 Cal. Rptr. at 587-88. One defendant company provided only 186 jobs of 650 planned and 139 were wrongfully terminated. The second defendant provided only 90 jobs of 550 planned and all were wrongfully terminated, and the third defendant failed to provide any of 400 jobs called for under the contract. *Id.*

<sup>198</sup> *Id.* at 399-400, 521 P.2d at 844, 113 Cal. Rptr. at 587-88.

The majority opinion focused on three factors in concluding that the plaintiffs were not third party donee beneficiaries.<sup>199</sup> First, the court drew a distinction between the government's "intent to benefit" the public — including the plaintiffs — and any intent to "make a gift."<sup>200</sup> Second, the court cited language in the contracts providing for the administrative resolution of disputes with the government as indicative of an intent to provide for government control over any enforcement action and not to confer legal rights on the private individuals.<sup>201</sup> Third, the court emphasized that the programs were designed to benefit the general public and only "incidentally" benefited the plaintiffs.<sup>202</sup>

The *Martinez* court's first and third factors are not persuasive and, in fact, are based on the same notion that the employment programs were not designed to benefit primarily the plaintiff-residents. The court erroneously suggested that these individuals were only indirectly benefited through a general public purpose program.<sup>203</sup> Applying the direct benefit test under the popular third party beneficiary rules, the court should have concluded that the public at large was to derive an *indirect* benefit through the provision of jobs *directly* to the class of persons to which the plaintiffs belonged.<sup>204</sup> If the third party standing test to be applied were simply that of a "direct benefit or assumption of direct obligation" to the third party, then most certainly this class of residents would have standing.

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<sup>199</sup> The Court used the creditor, donee or incidental beneficiary categorization test from the original Restatement Section 133 for establishing third party rights. No issue was raised at trial as to the plaintiffs not qualifying as creditor beneficiaries. *Id.* at 400, 521 P.2d at 844-45, 113 Cal. Rptr. at 588-89.

<sup>200</sup> The majority opinion states, in relevant part:

Unquestionably plaintiffs were among those whom the Government intended to benefit through defendants' performance of the contracts which recite that they are executed pursuant to a statute and a presidential directive calling for programs to furnish disadvantaged persons with training and employment opportunities. However, the fact that a Government program for social betterment confers benefits upon individuals who are not required to render contractual consideration in return does not necessarily imply that the benefits are intended as gifts.

*Id.* at 401, 521 P.2d at 845, 113 Cal. Rptr. at 589.

<sup>201</sup> *Id.* at 402-03, 521 P.2d at 849, 113 Cal. Rptr. at 589-90.

<sup>202</sup> *Id.* at 407, 521 P.2d at 848-49, 113 Cal. Rptr. at 592-93 ("Thus the contracts here were designed not to benefit individuals as such but to utilize the training and employment of disadvantaged persons as a means of improving the East Los Angeles neighborhood.")

<sup>203</sup> The *Martinez* majority had to distinguish, or could have overruled, the decision of an intermediate appellate court in *Shell v. Schmidt*, 126 Cal. App. 2d 279, 272 P.2d 82 (1954). In *Shell*, the plaintiffs, as military service veterans and homebuyers, were successful in claiming third party beneficiary standing under a contractual arrangement between the builder-vendor and the Federal Housing Authority (FHA). The arrangement required that the builders receive a priority for building materials for homes to be sold to veterans in exchange for promises to build the homes according to agreed specifications and to sell them at no more than an agreed maximum price.

The builder adhered to the maximum price limit but did not follow the building specifications. The court concluded, *inter alia*, that the federal program and related agreements between builders and the FHA were intended for the benefit of the veterans as a class and that the plaintiffs, as members of the class, had standing to enforce the contract. 126 Cal. App. 2d at 290, 272 P.2d at 89.

<sup>204</sup> See *Martinez*, 11 Cal. 3d at 409, 521 P.2d at 851, 113 Cal. Rptr. at 595 (Burke, J., dissenting). The dissenting justice stated:

The majority err in the above conclusion because the congressional purpose was to benefit both the communities in which the impact programs are established and the individual impoverished persons in such communities. The benefits from the instant contracts were to accrue directly to the members of the plaintiff's class, as a reading of the contracts clearly demonstrates.

*Id.* (footnotes omitted).

The second factor upon which the majority relied is not so clearly wrong, but is susceptible to criticism. The dispute resolution provisions established an enforcement mechanism and provided for certain refunds if the defendant corporations defaulted.<sup>205</sup> Although one could infer that this method was bargained for as the exclusive means of determining liability, to the exclusion of lawsuits by private residents, the truth is probably that the contracting parties did not specifically contemplate and intend to provide for any of the variety of lawsuits that might be brought by residents.<sup>206</sup> Moreover, the lack of persuasiveness in the majority view is indicated by the fact that the three dissenting justices were firmly convinced that the damages and dispute resolution provisions were not intended to preclude recovery by the residents.<sup>207</sup> The directness of benefit to the residents weighs strongly against this tenuous argument for denying the residents standing.<sup>208</sup>

In sum, the *Martinez* case involved the sort of government contract providing a limited scope of public services which should not be subject to the application of the Section 145 presumption against third party standing. Furthermore, the direct performance and benefit to the residents inherent in receiving employment, in the absence of an express or reasonably implied denial of third party standing, should have afforded them standing and an opportunity to present grounds for recovery under the defendants' contracts with the government.

Although at least one California court has subsequently reached a decision limiting the application of the *Martinez* holding,<sup>209</sup> a division of authority has developed in a series of cases involving lawsuits by tenants or purchasers of federally regulated low-income

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<sup>205</sup> *Id.* at 403-04, 521 P.2d at 847-48, 113 Cal. Rptr. at 590.

<sup>206</sup> Suits by the residents might have arisen in several contexts anywhere along the continuum from application for employment to eventual discharge. It is safe to say that the government would not have meant to preclude any and all individual suits. For example, an individual might have sued for discrimination in hiring or promotion.

<sup>207</sup> *Id.* at 414, 521 P.2d at 855, 113 Cal. Rptr. at 599 (Burke, J., dissenting, and Tobriner and Mosk, JJ., concurring in the dissenting opinion) ("These so-called 'liquidated damages' clauses nowhere purport to limit damages to the specified refunds. Nothing in the contracts limits the right to the government or, more importantly, plaintiffs' class, to seek additional relief.").

<sup>208</sup> In the *Shell* case, 126 Cal. App. 2d 279, 272 P.2d 82 (1954), the court was faced with a similar issue. Under the federal statute, the contractual arrangement expressly provided for two remedies: the government could prosecute violators and obtain monetary relief for purchasers and the purchasers could sue directly but only for violations of the maximum selling price fixed by the FHA and only within one year from the date of the violation. *Id.* at 286-87, 272 P.2d 86-87.

The court rejected the assertion that these remedies were exclusive, reasoning that "[t]he fundamental purpose would, in many cases be defeated if the statute were interpreted so as to deprive the veterans of their normal remedies to the benefit of defaulting contractors — the very class it was the purpose of the statute to protect veterans against." *Id.* at 287, 272 P.2d 87. The court further stated, "[i]t is no objection to an action by the third party that the contracting party (here the government) could also sue upon the contract for the same breach." *Id.* at 290, 272 P.2d at 89 (citation omitted).

The *Martinez* majority reasoned that these statements in *Shell* indicated that relief to the members of the public was contemplated by the contract of the parties in that case but that in the case before it the contract included no similar evidence of contemplated individual remedy. 11 Cal. 3d at 404, 521 P.2d at 847-48, 113 Cal. Rptr. at 591.

<sup>209</sup> See *Zigas v. Superior Court*, 120 Cal. App. 3d 827, 174 Cal. Rptr. 806 (1981) (distinguishing *Martinez* and following *Shell* in finding that tenants of federal mortgage insured housing were third party beneficiaries of provision in contract between landlord and federal government agency limiting rents that could be charged on reasoning that instant case and *Shell* involved benefit to limited group and not general public as in *Martinez*).

housing, with some courts reaching conclusions very similar to the conclusion reached by the *Martinez* court.<sup>210</sup> The government generally acts in the role of mortgage insurer in these arrangements under the National Housing Act.<sup>211</sup> As a condition to obtaining the federal insurance, the owners enter into regulatory agreements with the Secretary of Housing and Urban Development (HUD) requiring, among other things, that the housing projects be maintained in good repair and condition<sup>212</sup> and that rental charges not exceed moderate rates established by HUD.<sup>213</sup> The lawsuits initiated by the tenants generally have alleged that the landlords violated the regulatory agreements by either charging excessive rental fees<sup>214</sup> or failing to maintain the units in good repair.<sup>215</sup> These claims are to a large degree the flip sides of the same coin, since the government requires both a limit on rental fees and the proper maintenance of the property by the landlord. Because the latter requirement necessarily requires that the landlord devote some revenues to maintenance, the landlord may either increase rent or decrease maintenance to generate more profit. The provisions of the regulatory agreement essentially establish complementary requirements that rents be moderate and that proper funds be expended in maintenance.

Because the tenants are not parties to the regulatory agreements, standing has generally been sought on the ground that tenants are third party beneficiaries of the regulatory agreements between the housing owners and HUD.<sup>216</sup> Some of the cases have involved challenges by tenants to HUD-approved rent increases and have sought judicial review of the agency determinations. In these instances the courts have uniformly refused to review the determinations because they were committed by statute entirely to adminis-

<sup>210</sup> Cases holding that the tenants are third party beneficiaries include *Holbrook v. Pitt*, 643 F.2d 1261 (7th Cir. 1981) and *Zigas v. Superior Court*, 120 Cal. App. 3d 827, 174 Cal. Rptr. 806 (1981). Cases holding that the tenants are not third party beneficiaries include *Falzarano v. U.S.*, 607 F.2d 506 (5th Cir. 1979) and *Little v. Union Trust Co. of Maryland*, 45 Md. App. 178, 412 A.2d 1251 (1980). See also *Gonzalez v. City of Mission*, 620 S.W.2d 918 (Tex. Civ. App. 1981) (holding that recipient of funds from federal grant to rehabilitate homes was not third party beneficiary of grant agreement between city and federal government agency governing operation of housing rehabilitation program).

<sup>211</sup> 12 U.S.C. §§ 1701-1750 (1982). The insurance of mortgages is provided for in 12 U.S.C. § 1713.

<sup>212</sup> See, e.g., *Little v. Union Trust Co. of Maryland*, 45 Md. App. 178, 179, 412 A.2d 1251, 1253 (1980) ("Paragraph 7 of the Agreement provided in part: 'Owners shall maintain the mortgaged premises, accommodations and the grounds and equipment appurtenant thereto, in good repair and condition.'").

<sup>213</sup> See, e.g., *Harlib v. Lynn*, 511 F.2d 51, 53 (7th Cir. 1975) ("The regulatory agreement included paragraph 4(b): 'Owners shall make dwelling accommodations and services of the project available to occupants at charges not exceeding those established in accordance with a schedule approved in writing by the Commissioner.'").

<sup>214</sup> See, e.g., *id.*; *Angleton v. Pierce*, 574 F. Supp. 719 (D. N.J. 1983).

<sup>215</sup> See, e.g., *Perry v. Housing Authority of City of Charleston*, 664 F.2d 1210, 1211 (4th Cir. 1981); *Little v. Union Trust Co. of Maryland*, 45 Md. App. 178, 180, 412 A.2d 1251, 1253 (1980).

<sup>216</sup> In some cases the claimants have also pleaded other bases for relief including a private cause of action arising under the federal statute, see *Perry v. Housing Authority of City of Charleston*, 664 F.2d 1210, 1213-14 (4th Cir. 1981); *Falzarano v. United States*, 607 F.2d 506, 509-11 (5th Cir. 1979) (both denying any private cause of action applying the test of *Cort v. Ash*, 422 U.S. 66 (1975)); or a constitutional law — due process claim, see *Holbrook v. Pitt*, 643 F.2d 1261, 1280-81 (7th Cir. 1981) (finding that tenants did have a due process claim as to rent assistance payments); *Angleton v. Pierce*, 574 F. Supp. 719, 732 (D. N.J. 1983) (no violation of rights to due process found in plan to convert rental housing into cooperative ownership units).

trative discretion.<sup>217</sup> In relation to the determination of third party contract beneficiary standing, the approved rent increase cases are irrelevant. These cases indicate that when HUD approves the rent increases no breach of the regulatory agreement by the landlord has occurred.<sup>218</sup> Even if the tenants were clearly recognizable third party beneficiaries they would have no relief in the absence of a breach. The analysis of third party standing, therefore, should be carefully separated from the question of alleged breach related to HUD-approved rent increases.<sup>219</sup> The third party standing analysis revolves around the question whether the agreement between HUD and the housing owners reflects sufficient intent to benefit the tenants to confer an enforceable right.

As suggested previously, the courts which have denied third party standing to tenants have engaged in reasoning very similar to the reasoning employed by the *Martinez* court.<sup>220</sup> In *Falzarano v. U.S.*,<sup>221</sup> for example, the Court of Appeals for the First Circuit considered a case based on allegations of excessive rent and physical plant disrepair resulting from illegal appropriation of funds by the landlords.<sup>222</sup> The plaintiff-tenants alleged that these acts breached the regulatory agreement between HUD and the owners and sought standing as third party beneficiaries of that agreement.<sup>223</sup> In considering the third party beneficiary claim, as well as the possibility of a statutory private cause of action, the court reached the somewhat inconsistent conclusions that "[l]ow and moderate income tenants are indisputably the prime beneficiaries of the National Housing Act,"<sup>224</sup> but that the regulatory agreements "did not disclose an intent to benefit the tenants, except as they might be incidental beneficiaries; nor can the tenants qualify as either creditor or donor [sic] beneficiaries."<sup>225</sup> The *Falzarano* court seemed to be persuaded that the rent controls were primarily intended to allow HUD to oversee and insure the financial viability of the projects, with the goal of preventing default and federal liability as mortgage insurer.<sup>226</sup> While the court's reasoning is not clearly articulated, the *Falzarano* opinion can be fairly read as concluding that the more direct, intended benefit of the rent

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<sup>217</sup> *Falzarano v. United States*, 607 F.2d 506, 512 (5th Cir. 1979). See also *Harlib v. Lynn*, 511 F.2d 51, 56 (7th Cir. 1975). The statute initially did not provide for any tenant participation in rental increase hearings. HUD, however, has subsequently promulgated regulations which now afford the tenants such rights. *Id.* at 55.

<sup>218</sup> See *Harlib*, 511 F.2d at 55 ("the language . . . of [the] agreement contemplates rent increases pursuant to the procedures followed in this case. . . ." *Id.* at 56.).

<sup>219</sup> For example, the *Harlib* case, 511 F.2d 51 (7th Cir. 1975), although it involved an allegation of third party beneficiary rights, did not address the standing issue but instead concluded that the regulatory agreement contemplated rent increases without hearings so that no breach would have been found even if the third party beneficiaries had standing. *Id.* at 56.

The court in *Angleton v. Pierce*, 574 F. Supp. 719 (D. N.J. 1983), apparently relies on cases such as *Harlib*, which did not actually involve a standing issue, in support of its denial of standing. 574 F. Supp. at 735-36.

<sup>220</sup> See *supra* notes 194-208 and accompanying text.

<sup>221</sup> 607 F.2d 506 (5th Cir. 1979).

<sup>222</sup> *Id.* at 508.

<sup>223</sup> *Id.* The tenants also asserted other causes of action based on an implied right of action under the National Housing Act, breach arising out of the lease agreements, and the fourteenth amendment to the United States Constitution for deprivation of their rights under color of state law.

<sup>224</sup> *Id.* at 509.

<sup>225</sup> *Id.* at 511.

<sup>226</sup> *Id.* at 510 ("To safeguard the federal fisc against possibly disastrous exposure should the insured mortgages be foreclosed, the Secretary of HUD is permitted to regulate rents, charges and methods of operation. An overriding concern is to guarantee that the rents and charges adequately cover the carrying costs of the projects.").

control provision was to the federal government as insurer of the mortgage; the benefit to the tenants was considered merely incidental to the purpose of protecting the government's interest. In reaching this conclusion the court apparently considered the government public service contract rule applicable<sup>227</sup> and seemed to ignore the allegation of breach through failure to maintain the buildings.

An even more recent case, *Perry v. Housing Authority of City of Charleston*,<sup>228</sup> was entirely concerned with maintenance and safety hazards.<sup>229</sup> The court in *Perry*, as did the court in *Falzarano*, considered claims based on both a statutorily implied private cause of action and third party beneficiary rights<sup>230</sup> and reasoned that the statute had two beneficiaries — the states who received assistance for housing projects through the funding programs "as direct beneficiaries and low-income families as indirect beneficiaries."<sup>231</sup> The court went on to address specifically the third party claim and concluded that the plaintiffs were at best incidental beneficiaries of the agreement between the owner and HUD.<sup>232</sup> This conclusion was reached very summarily<sup>233</sup> and rested upon the questionable authority of *Falzarano* and the inapposite authority found in HUD-approved rent increase cases.<sup>234</sup>

At least two courts have disagreed with the outcomes in *Falzarano* and *Perry* and have concluded that tenants are third party beneficiaries of the regulatory agreements between owners and HUD.<sup>235</sup> These courts concluded that the benefit to the tenants was the primary purpose of rental fee limits or similar provisions in the HUD agreements. The Court of Appeals for the Seventh Circuit in *Holbrook v. Pitt*<sup>236</sup> rejected an argument to the contrary as displaying "an astonishing lack of perspective about government social welfare programs."<sup>237</sup> The court went on to state that "[i]f tenants are not the primary

<sup>227</sup> *Id.* at 511. The court cited the RESTATEMENT OF CONTRACTS § 145. See *supra* note 155.

<sup>228</sup> 664 F.2d 1210 (4th Cir. 1981).

<sup>229</sup> More specifically, the plaintiffs alleged that the low-income housing project was in such a state of disrepair as to pose "hazards to the health, safety and welfare" of the residents. "The hazards included, *inter alia*, the use of lead-based paint, deterioration of the flooring and roofing, inadequate lighting and security patrols, and inadequate garbage pick-up contributing to infestation by rats and other vermin." 664 F.2d at 1211.

<sup>230</sup> *Id.* The plaintiffs also advanced a claim under 42 U.S.C. § 1983 for deprivation of constitutional or federally created rights under color of state law. *Id.*

<sup>231</sup> *Id.* at 1213. In support of this conclusion the court quoted the preamble to the Housing Act found at 42 U.S.C. § 1437, which reads in relevant part: "[i]t is the policy of the United States to promote the general welfare of the Nation by employing its funds . . . to assist the several states . . . to remedy the unsafe and unsanitary housing conditions and the acute shortage of decent, safe and sanitary dwellings for families of low income. . . ." *Id.* at 1212.

<sup>232</sup> *Id.* at 1218.

<sup>233</sup> The district court had not considered the third party beneficiary claim but the Court of Appeals considered the law so clear that it decided the issue without remand. *Id.* at 1218 n.16.

<sup>234</sup> *Id.* at 1218, including *Harlib*, 511 F.2d 51 (7th Cir. 1975). See *supra* notes 217-19 and accompanying text. The *Perry* court did not directly cite Section 145 of the Restatement of Contracts but did cite that part of the *Falzarano* case which did.

<sup>235</sup> *Holbrook v. Pitt*, 643 F.2d 1261 (7th Cir. 1981); *Zigas v. Superior Court*, 120 Cal. App. 3d 827, 174 Cal. Rptr. 806 (1981).

<sup>236</sup> 643 F.2d 1261 (7th Cir. 1981). The *Holbrook* case differs on the facts somewhat from the other related cases in that it involved rent subsidy payments to reduce the amount of rent the tenants were required to pay as part of a program to assist projects with federally insured mortgages, 643 F.2d at 1264-65, but the reasoning of this case is very pertinent to the others. The tenants alleged, essentially, that the commencement of the rent subsidy payments was improperly delayed and that the delay constituted a breach of the HUD regulatory agreement of which they were third party beneficiaries. *Id.*

<sup>237</sup> *Id.* at 1271.

beneficiaries of a program to provide housing assistance payments to low-income families, the legitimacy of the multi-billion dollar . . . program is placed in grave doubt."<sup>238</sup> The California Court of Appeals considering the case of *Zigas v. Superior Court of San Francisco* placed particular emphasis on the statement of purpose contained in the National Housing Act: "[t]he insurance of mortgages under this section is intended to facilitate particularly the production of rental accommodations, at reasonable rents. . . ."<sup>239</sup> The court went on to conclude that the tenants were intended to benefit from the limits on rental fees and were entitled to standing to sue as third-party beneficiaries.<sup>240</sup> The court convincingly stated that the limits on rent were "obviously" intended to protect the tenants from arbitrary increases and not to benefit the government as mortgage insurer.<sup>241</sup>

The conclusion of the *Zigas* court regarding limits on rental fees may be extended to the maintenance requirements set forth in contracts between housing project owners and HUD. While the government, as mortgage insurer, would ultimately benefit from the required proper maintenance of the physical plant, that benefit is much less direct and certain than the benefit to be derived by tenants from such requirements, since the tenants' health and safety would be immediately enhanced by proper performance under this part of the HUD-landlord regulatory agreement.

Leaving aside the conflicting positions taken by different courts regarding these kinds of contracts, a measuring of the circumstances involved in such contracts against the relevant components of established third party standing rules is instructive. First of all, no express denials or affirmations of third party standing are contained in either the regulatory agreements or the surrounding circumstances. Moreover, there should not be a presumption against standing in this type of limited scope government contract. The tenants in these cases stand in a different position from plaintiffs in true public service cases, such as users of water services or riders of mass transit vehicles, since the tenants are quantitatively limited and easily identifiable. While the tenants certainly cannot be categorized as "classic creditor" or "classic donee" beneficiaries, they arguably stand to "directly," "immediately" and "necessarily" benefit if the promises to limit rents and maintain the buildings are honored.

As suggested by the *Zigas* and *Holbrook* courts, the tenants will most directly benefit from faithful performance of the obligations of the owners. In contrast, the potential benefit to the government, as mortgage insurer, from observance of the maximum rental

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<sup>238</sup> *Id.* The court continued:

Congress did not establish the Section 8 housing assistance program merely to limit claims on HUD's insurance fund that might be occasioned by assignments or foreclosures of HUD-insured mortgages. Congress authorized Section 8 payments "[f]or the purpose of aiding lower-income families in obtaining a decent place to live and of promoting economically mixed housing."

*Id.* (quoting 42 U.S.C. § 1437f(a) (1976)).

<sup>239</sup> 120 Cal. App. 3d 827, 835, 174 Cal. Rptr. 806, 810 (1981).

<sup>240</sup> *Id.* at 836, 174 Cal. Rptr. at 810. The court distinguished the instant case from *Martinez*, *supra* notes 196-208, on several grounds including, very significantly, that the contracts in *Martinez* were deemed by that court to be intended to benefit the public rather than the individuals, whereas in the instant case, as in *Shell*, *supra* notes 203, 208, the purpose was to benefit a narrow and specific group — low income families needing rental housing. *Id.* at 838, 174 Cal. Rptr. at 812. When carefully studied the factual differences among the three cases appear to be without significance.

The court also properly distinguished *Falzarano* and similar cases, *supra* notes 217-19 and accompanying text, on the grounds that they involved HUD approved rent increases. *Id.* at 840, 174 Cal. Rptr. at 813.

<sup>241</sup> *Id.* at 839, 174 Cal. Rptr. at 812.

limits and maintenance requirements seems far more tenuous. If rental limits were greatly exceeded, a shortage of tenants could occur and the shortage might lead to default. This concern seems not to be manifested in the agreements and surrounding circumstances. Rather, the motivating concern for rent limitations seems to be to provide housing that will be affordable to low income residents. Similarly, while proper maintenance of the buildings might ultimately protect the government's security interest in the event of a default on a project, the tenants would benefit on a daily basis from such proper maintenance.

Contrasting the tenants' interest with the general public's interest is also helpful to the analysis. Members of the general public would probably derive some intangible benefit through the provision of low-income housing to those in need of public assistance, and certainly would benefit as taxpayers from avoidance of default on the federally insured mortgages. These benefits, however, are far more remote than the immediate benefits enjoyed by the particular tenants and would flow indirectly from such benefits. For all these reasons, the courts that have avoided misapplication of rules relating to government public service contracts and have decided that tenants of low-income housing should be deemed recognizable third party beneficiaries have reached decisions that are more consistent with decisions in cases involving other recognized categories of enforceable third party beneficiary rights.

#### F. Construction Contract Cases

Construction contract cases involve several parties standing in a variety of relationships: owners, attempting to recover for breach of contract by a subcontractor with whom they have no direct contractual relationship; subcontractors, wishing to recover either from surety companies or owners for damages resulting from breach by a general contractor; contractors, attempting to recover for injuries resulting from another contractor's breach of the latter's agreement with the owner; or adjacent property owners, wishing to recover from contractors for damages resulting from their performance under the construction agreement. Each of these categories of relationships will be examined in turn.

##### 1. Owner Versus Remote Subcontractor Cases

In a very significant and often cited case in North Carolina, *Vogel v. Reed Supply Co.*,<sup>242</sup> the North Carolina Supreme Court considered a claim by the plaintiff-owners that they were third party beneficiaries of a subcontract between the general builder and the defendant. The subcontract provided that the defendant would perform certain duties in the construction of an apartment building for the owner.<sup>243</sup> In deciding that the owner was not a third party beneficiary, the court acknowledged that the owner would benefit from the subcontractor's performance but considered that benefit to be indirect — accrued only through a more direct benefit to the general builder — and not the sort of

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<sup>242</sup> 277 N.C. 119, 177 S.E.2d 273 (1970). In *Vogel* the court expressly approved the Restatement of Contracts Section 133 formula as correctly stating the law of North Carolina. *Id.* at 127-28, 177 S.E.2d at 278.

<sup>243</sup> *Id.* at 125, 177 S.E.2d at 275 (Reed, the subcontractor, was to furnish and erect walls, subfloor, roof work, windows, doors, and was to paint and perform other similar services).

benefit intended by the contracting parties to be enforced by a third party.<sup>244</sup> The reasoning in *Vogel* is consistent with a strict reading of the established rule that third parties may enforce a contract only when the benefit is direct.<sup>245</sup>

The reasoning in cases reaching the opposite conclusion, however, is also persuasive. The Oklahoma Supreme Court, for example, reached the opposite conclusion from the *Vogel* court in a recent case involving very similar facts, *Keel v. Titan Construction Co.*<sup>246</sup> The Oklahoma court reasoned that while the general contractor was a "primary" beneficiary of its contract with the subcontractor, the owner was equally a "primary" beneficiary and therefore should be allowed third party standing.<sup>247</sup> While the Oklahoma court included the term "direct" in describing the benefit required for third party standing,<sup>248</sup> the court did not seize upon that aspect of the state rule in this case. The Supreme Court of Alaska cited *Keel* in reaching a similar decision allowing an owner third party standing.<sup>249</sup> The Alaska court emphasized that the contract must be made "expressly for the benefit of a third person" and that the subcontractor in a construction project must know that there is an owner and that the work is intended to benefit the owner.<sup>250</sup> The owner in this type of case also has been found to be a creditor beneficiary on the reasoning that the general contractor owes a duty to the owner and the subcontractor's performance fulfills part of that obligation.<sup>251</sup>

Both the restrictive position of the North Carolina court and the more liberal approach of the Oklahoma and Alaska courts are defensible in some respects. Close questions like the one presented in this type of case<sup>252</sup> bring into focus again the potential conflict between two basic guiding principles: the idea that parties are presumed to contract for themselves, so that third party standing is appropriate only when actually intended by the parties, and the idea that standing ought to be allowed whenever it is consistent with the manifest purpose of the contract.<sup>253</sup> For the courts of those states

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<sup>244</sup> *Id.* at 129, 177 S.E.2d at 279. The court stated:

In our view the subcontract here was not intended for the benefit of the plaintiff landowner. Plaintiff benefits only incidentally or indirectly because performance of the subcontract was rendered in fulfillment of Reed's obligation to the general contractor. Hence, any benefit derived from the subcontract by the landowner would necessarily accrue indirectly, i.e., through the general contractor.

<sup>245</sup> See also *Midwest Concrete Products Co. v. LaSalle National Bank*, 94 Ill. App. 3d 394, 397, 418 N.E.2d 988, 990 (1981). The court cited *Vogel* in concluding that the operator of a sports center was not a third party beneficiary of a contract between general and subcontractor for the latter to install racquetball courts in the center. Although the operator would derive benefit from proper performance, the parties were deemed to contract "entirely in their own self interest." *Id.*

<sup>246</sup> 639 P.2d 1228 (Okla. 1982).

<sup>247</sup> *Id.* at 1231.

<sup>248</sup> *Id.* The court was construing 15 O.S. 1971 § 29 which provides: "A contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it." The court construed "expressly" to mean "in an express manner; in direct or unmistakable terms; explicitly; definitely; directly." (quoting *Watson v. Aced*, 156 Cal. App. 2d 87, 319 P.2d 83 (1957)).

<sup>249</sup> *Syndoulos Lutheran Church v. A.R.C. Industries, Inc.*, 662 P.2d 109 (Alaska 1983).

<sup>250</sup> *Id.* at 114.

<sup>251</sup> See *Gilbert Financial Corp. v. Steelform Contracting Co.*, 82 Cal. App. 3d 65, 145 Cal. Rptr. 448 (1978).

<sup>252</sup> See *Port Chester Electrical Construction Corp. v. Atlas*, 40 N.Y.2d 652, 656-57, 357 N.E.2d 983, 985-86, 389 N.Y.S.2d 327, 330-31 (1976), on the difficulty of applying third party beneficiary rules to these types of cases.

<sup>253</sup> See *supra* notes 41-49 and accompanying text.

adhering to the former principle, standing probably ought to be denied to the owner because of the presumption against third party standing. But it should be remembered that although this presumption is widespread, it is quite vulnerable to the argument that it serves no intrinsically valuable purpose.<sup>254</sup> On the other hand, the courts of those states operating without such a presumption in third party standing cases should find it more reasonable to allow standing, since granting standing would be consistent with the contracting parties' basic understanding that the subcontractor must render a proper performance, for the ultimate benefit of the owner, or be liable for breach.<sup>255</sup> Standing on the part of the owner in these cases may be sought either to increase the chances of recovery by suing multiple parties or because the general contractor is not involved in the litigation.<sup>256</sup> In the latter case, if the owner is denied standing, the subcontractor may totally escape the consequences of having failed to render the performance for which he received compensation. Consequently, granting standing to the owner seems warranted, but this standing is not necessarily what the parties contracted for nor is it the result of finding an indisputably direct benefit or performance running to the owner. As long as courts vary in their basic presumptions about third party standing these types of close cases will probably result in conflicting decisions.

## 2. Surety and Retainage Agreement Cases

State and federal courts seem to have reached some consensus concerning the ability of unpaid subcontractors to recover as third party beneficiaries of surety contracts. The courts have given similar treatment to general contractors who wish to recover funds held under loan agreements that permit the lender to retain a percentage of the construction funds until the work is completed. The key to success in these cases is the presence of an ascertainable promise to pay funds directly to the party seeking third party standing.<sup>257</sup>

<sup>254</sup> See *supra* notes 46-49 and accompanying text.

<sup>255</sup> The case of *Richardson Engineering Company v. IBM*, 554 F. Supp. 467 (D. Vt. 1981), *aff'd*, 697 F.2d 296 (2d Cir. 1982) presents an analogous but somewhat easier case. In *Richardson Engineering*, the subcontractor waived its right to assert a lien against the building under construction for the owner. The subcontractor asserted that because the waiver appeared in the contract between it and the general, the owner was not entitled to enforce it. Reasoning that the owner of the building was clearly the beneficiary of a reduction of the threat of liens, the court rejected this argument. *Id.* at 471. The placing of a roof on a building or a floor in the building is not quite the same as waiving the right to a lien but the benefit to the owner seems very substantial in each instance.

<sup>256</sup> For example, in *Vogel*, 277 N.C. 119, 177 S.E.2d 273 (1970), the trial court concluded that the general was unable to bring suit against the subcontractor because it was not a licensed general contractor under North Carolina law and therefore could not sue to enforce its contracts. *Id.* at 124, 177 S.E.2d at 276. The North Carolina Supreme Court, however, reversed and decided that the general could sue on its subcontract. *Id.* at 133, 177 S.E.2d at 282. In *Syndoulus, Lutheran Church v. A.R.C. Industries, Inc.*, 662 P.2d 109 (Alaska 1983), the general had abandoned the project without cause, 662 P.2d at 110, and although the owner sued the general, it probably sought to obtain a judgment against the subcontractor to increase the likelihood of actual recovery. Finally, in *Richardson Engineering Company v. I.B.M.*, 554 F. Supp. 467 (D. Vt. 1981), *aff'd*, 697 F.2d 296 (2d Cir. 1982), the third party beneficiary claim was raised as a counterclaim in a suit brought directly against the owner by the subcontractor. The general apparently was not made a party by the subcontractor.

<sup>257</sup> See, e.g., *Taylor Woodrow Blitman Construction Co. v. Southfield Gardens Co.*, 534 F. Supp. 340, 343-44 (D. Mass. 1982) (general contractor could not recover on retainage held by lender where finance agreement contemplated benefit to laborers and suppliers but included no promise to pay the general contractor); *Treasure State Industries, Inc. v. Welch*, 173 Mont. 403, 407-08, 567 P.2d 947, 949-50 (1977) (third-party material man could not recover on surety bond in absence of a

Consequently, courts have been careful to distinguish between performance bonds and payment bonds.<sup>258</sup> A performance bond usually contains a promise by the surety to compensate the owner for any consequences of the general contractor's failure to perform. A payment bond, on the other hand, usually requires that the surety complete payment to any suppliers of material or labor who are not fully paid by the general contractor. While in a payment bond there is a promise to pay directly to a subcontractor, a performance bond includes no such promise of direct payment.<sup>259</sup> Similarly, in cases involving loan agreements permitting retainage by the lender of a percentage of progress payment advances, the courts have considered the presence of a promise to pay directly either the general contractor or the subcontractor to be decisive of the issue of third party standing for those parties seeking the retained funds.<sup>260</sup>

The emerging area of difficulty, and perhaps flexibility, in these cases is the question of how to interpret the express language of the security or retainage agreement. In the case of *Jacob Associates v. Argonaut Ins. Co.*,<sup>261</sup> the Supreme Court of Oregon reversed a well established line of cases which held that surety contracts couched in "terms of condition," rather than language of express promises to pay, did not yield third party rights to subcontractors.<sup>262</sup> The majority, despite an adverse concurrence and a vigorous dissent, overruled the trial court's sustainment of a demurrer and decided that the rather "archaic" language of the bond should be interpreted, as a matter of law, as being equivalent to a promise to pay.<sup>263</sup> The concurring and dissenting justices proposed a less frontal assault on the legal precedent and the bond's express language, and instead suggested

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"specific promise to pay"); *Henson Construction, Inc. v. Reintree Corp.*, 685 P.2d 1062, 1065-66 (Wash. 1984) (en banc) (sidewalk contractor could not recover as third party beneficiary of performance bond posted by plot developer for the benefit of the city to insure that sidewalks would be made, where bond given contained no promise to pay); *Wyoming Machinery Co. v. U.S. Fidelity and Guaranty Co.*, 614 P.2d 716, 721 (Wyo. 1980) (subcontractor deemed not to be third party beneficiary of surety bond because of absence of a "specific promise to pay").

<sup>258</sup> See generally *Taylor Woodrow Blitman Construction Co. v. Southfield Gardens Co.*, 534 F. Supp. 340, 343-44 (D. Mass. 1982); *Cretex Companies, Inc. v. Construction Leaders, Inc.*, 342 N.W.2d 135, 137-38 (Minn. 1984) and cases cited therein.

<sup>259</sup> Circumstances might be such that delivery of a building subject to a lien because of nonpayment of a supplier of labor constitutes a breach of a performance bond. If so, then the surety may be required to absolve the lien through payment or some other means. Despite the possibility that a performance bond may indirectly lead to payment, it still will not be read to require direct payment in the first instance. See *Wyoming Machinery v. U.S. Fidelity & Guaranty Co.*, 614 P.2d 716, 720-21 (Wyo. 1980).

<sup>260</sup> See *Taylor Woodrow Blitman Construction Co. v. Southfield Gardens Co.*, 534 F. Supp. 340, 343-44 (D. Mass. 1982) (general contractor could not recover on retainage agreement without express promise to pay to the general contractor); *Westinghouse Electric Supply Co., Inc.*, 119 N.H. 833, 838, 409 A.2d 1141, 1144 (1979) (third party beneficiary standing "depended upon an express provision in the contract between the project owner and general contractor providing for both an amount retained by the owner and payment directly toward claims of suppliers").

<sup>261</sup> 282 Or. 551, 580 P.2d 529 (1978) (en banc).

<sup>262</sup> *Id.* at 553-54, 580 P.2d at 529-30. The plaintiff was a subcontractor engineering firm with a claim for \$10,891.94 left unpaid by the general contractor who had been adjudicated bankrupt. The defendant was surety on the general bond in favor of the owner; the bond recited that the surety's obligation "shall be void" on the condition that the general "pay all persons, firms and corporations who perform" on the project but that otherwise the bond would "remain in full force and effect." *Id.*

<sup>263</sup> The majority cited law in other jurisdictions, 4 A. CORBIN, CONTRACTS § 800, L.P. SIMPSON, CONTRACTS (2d ed.) 252, n.57, and RESTATEMENT OF CONTRACTS § 133, illustration 4, all in support of its conclusion that words of condition should be construed as an express promise to pay unpaid laborers, materialmen and subcontractors. 282 Or. at 554-56, 580 P.2d at 530-31.

that the particular circumstances of the case might support a conclusion that these parties intended the words of condition to amount to a promise in this case.<sup>264</sup> Other courts have also indicated some inclination to find a promise to pay from less than express language.<sup>265</sup>

An important point to be noted from all of the cases in this subgroup is a disinclination of the courts to depart from the requirement that the contract contain language somehow amounting to a promise to pay directly in order to justify third party standing. Even the majority in *Jacob Associates* sought to find such a promise to pay. This element of promised direct performance is consistent with rules found in other categories of cases discussed previously<sup>266</sup> and is stringently applied even though the putative third party beneficiaries might derive a very substantial, but indirect, benefit from other indemnification or performance types of surety and retainage agreements.

### 3. Multi-prime Contractor Cases

Another variety of the construction cases are cases involving not subcontractual relations but "multi-prime" contracts or several contracts directly between the owner and various parties in the construction project. In these situations, one contractor may attempt to recover from another because of a breach by the other party of its contract with the owner. Such claimants have received varying responses from the courts. The Supreme Court of New Jersey, faced with a rather straightforward case in *Broadway Maintenance Corp. v. Rutgers*,<sup>267</sup> decided that fellow contractors should have third party standing on the basis of one prime contractor's agreement with the owner to provide coordination for the other prime contractors.<sup>268</sup> In that case, the several contracts with the owner also expressly included a provision that each contractor would "pay all cost and expenses" incurred by other parties due to its delays and permitted the withholding of funds by the owner to be used for that purpose.<sup>269</sup> At least one other court has found third party standing among

<sup>264</sup> The concurring justices offered that the plaintiff should have an opportunity to prove that the contracting parties' understanding was that the bond included a promise to pay, 282 Or. at 561, 580 P.2d at 533 (Linde, Lent, JJ., concurring), while the dissenting justice stated, "[i]f there is an ambiguity, because of the archaic form of the bond, as to what the parties intended, it would be proper to submit proof showing what the parties did intend." *Id.* at 564, 580 P.2d at 535 (Holman, J., dissenting).

<sup>265</sup> See *Matter of Gebco Inv. Corp.*, 641 F.2d 143, 147 (3d Cir. 1981) (despite absence of express promise to pay, record demonstrated that contractual parties understood that retainage was for benefit of subcontractors); *Howell v. Worth James Construction Co.*, 259 Ark. 627, 630, 535 S.W.2d 826, 829 (1976) (circumstances supported interpretation that retainage provision was designed for benefit of fellow contractor). See also *Wyoming Machinery*, 614 P.2d 716, 725-27 (Wyo. 1980) (dissenting opinion in 3-2 decision) (distinguishing the express "promise to pay" standard as being more narrow than the appropriate "intent to benefit" measure, and asserting that in the instant case the promise to pay was sufficiently expressed or was indicated "by reasonable implication").

<sup>266</sup> For example, creditor cases, see *supra* text accompanying notes 126-239, and gift cases, see *supra* text accompanying notes 140-52.

<sup>267</sup> 90 N.J. 253, 447 A.2d 906 (1982).

<sup>268</sup> *Id.* at 261, 447 A.2d at 910-11. One prime contractor was designated as the general contractor but the other contractors also contracted directly with the owner. No subcontractual relations existed between these parties. *Id. Accord John E. Green Plumbing & Heating, Inc. v. Turner Construction Co.*, 742 F.2d 965, 966 n.2 (6th Cir. 1984) (applying Michigan law).

<sup>269</sup> 90 N.J. at 261, 447 A.2d at 910-11.

multi-prime contractors with a less express promise,<sup>270</sup> but other courts have split on the standing question in similar cases.<sup>271</sup>

The facts found in the case of *Buchman Plumbing Co. v. Regents of University of Minnesota*<sup>272</sup> provide a contrast to those in the *Broadway Maintenance* case. In *Buchman* several prime contractors each entered into agreements with the project owner which indicated that the work was to be completed within 200 days. The owner agreed to be liable to each contractor for delay damages it caused and each contractor agreed to reimburse the owner for any liability to others arising from delays which that contractor might cause.<sup>273</sup> One contractor brought an action alleging that it was unable to complete its work in 200 days, and therefore suffered delay damages, because of the failure of a fellow contractor to render timely performance.<sup>274</sup> The Minnesota court reasoned that even if the fellow contractor had breached, no third party rights would exist in the injured contractor because the 200 day completion provision was included for the benefit of the owner. Moreover, the court was persuaded that proper performance by one fellow contractor would not fulfill the general obligation of the owner to the contractors to provide a suitable work site and avoid delay.<sup>275</sup> In the *Buchman* case each contractor would undoubtedly benefit from prompt performance by the others but any intention by the contracting parties to create a direct obligation or confer an enforceable right upon one contractor against the others was not clear. Unlike the *Broadway Maintenance* case, there was no contractual agreement in *Buchman* to shift the owner's obligations onto one or more of the fellow prime contractors nor any direct promise to pay other contractors for damages.

Similar questions have been raised in cases involving an alleged breach by an architect or other party whose performance affects the performance of the contractors in the project. The courts have generally agreed with the *Buchman* reasoning in holding that the architect's contract will not be deemed for the benefit of the contractors because it is entered into primarily for the benefit of the owner and not to create a direct obligation to the contractor.<sup>276</sup> These decisions warrant some scrutiny, however, in light of the substantial interest that a contractor may have in the architect's proper performance. In the case of *COAC, Inc. v. Kennedy Engineers*,<sup>277</sup> the California Court of Appeals, in overruling sustainment of a demurrer, found that the general contractor was a creditor beneficiary of an engineering firm's contract with the owner to produce an environmental impact report required by state law. The court reasoned that the owner owed a duty to the contractor to obtain the environmental impact report and had contracted with the defendant to discharge that duty.<sup>278</sup> Among the cases cited by the court was the *Visintine*

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<sup>270</sup> *Shea-S&M Ball v. Massman-Kiewit-Early*, 606 F.2d 1245, 1249 (D.C. Cir. 1979). One contractor was obligated to prevent overflows of water from its construction site into the adjacent construction site of a fellow contractor. The fellow contractor was found to be a third party beneficiary of that obligation. *Id.*

<sup>271</sup> See cases cited in *Broadway Maintenance*, 90 N.J. at 260, 447 A.2d at 909.

<sup>272</sup> 298 Minn. 328, 215 N.W.2d 479 (1974).

<sup>273</sup> *Id.* at 332, 215 N.W.2d at 481-82.

<sup>274</sup> *Id.*

<sup>275</sup> *Id.* at 336, 215 N.W.2d at 484-85.

<sup>276</sup> See *Williams v. Fenix & Scisson, Inc.*, 608 F.2d 1205, 1209 (9th Cir. 1979); *Engle Acoustic & Tile, Inc. v. Grenfell*, 223 So. 2d 613, 620 (Miss. 1969); *Valley Landscape Co., Inc. v. Rolland*, 218 Va. 257, 261-62, 237 S.E.2d 120, 123 (1977).

<sup>277</sup> 67 Cal. App. 3d 916, 136 Cal. Rptr. 890 (1977).

<sup>278</sup> *Id.* at 923, 136 Cal. Rptr. at 893.

case from Ohio where a third party contractor was also deemed to be a creditor beneficiary of another contractor's promise to the owner to fulfill the owner's duty to provide preparatory work essential to the third party's performance.<sup>279</sup>

It is reasonable to conclude, then, that in the absence of an express promise for the benefit of the third party, the decisive determination in this type of case will be whether one contractor has assumed a direct or specific obligation owed by the owner to provide conditions required for another contractor's performance.<sup>280</sup> This result can be contrasted with arrangements where the contractor or architect performs a duty primarily to benefit the owner and does not assume a direct, specific obligation to the fellow contractor.<sup>281</sup> Because of this distinction, cases such as *Buchman* and *Broadway Maintenance* are reconcilable.

#### 4. Promise to Repair Cases

A last area of third party claims in construction contracts typically involves adjacent property owners who suffer property damage during the course of work done by a contractor and then seek to recover on the basis of a provision in the construction contract requiring the contractor to repair any damage caused during the course of performance.<sup>282</sup> In a rather well established line of cases, the courts have considered such clauses to amount to a promise to compensate directly the injured property owners and have allowed third party standing.<sup>283</sup> In some cases third party standing has been allowed even though the contract did not contain a specific promise to pay damages to the injured party, but instead contained a more simple promise to be responsible for damages in lieu of the owner.<sup>284</sup> This liberality in interpretation is far from unlimited, however, and the courts will most certainly honor a clause expressly denying an intent to create third party rights even when the other contractual provisions might otherwise support third party standing.<sup>285</sup> Also, the parties may expressly limit the promisor's obligation to indemnifica-

<sup>279</sup> 169 Ohio St. 505, 160 N.E.2d 311 (1959), discussed *supra* note 181 and accompanying text.

<sup>280</sup> See, e.g., *Shea-S&M Ball v. Massman-Kiewit-Early*, 606 F.2d 1245, 1249 (D.C. Cir. 1979) (prevent water from flooding into another contractor's work site); *COAC, Inc. v. Kennedy Engineers*, 67 Cal. App. 3d 916, 921, 136 Cal. Rptr. 890, 892 (1977) (provide mandatory environmental impact report).

<sup>281</sup> See, e.g., *Williams v. Fenix & Scisson, Inc.*, 608 F.2d 1205, 1209 (9th Cir. 1979) (duty to conduct safety inspections and make recommendations to owner); *Valley Landscape Co., Inc. v. Rolland*, 218 Va. 257, 261-62, 237 S.E.2d 120, 123 (1977) (provide plans to owner according to his desires and conduct supervisory services to insure that plans are followed).

<sup>282</sup> These cases do often involve governmental parties as owners but in light of the limited scope of "promises to repair" clauses, the special rules for public service contracts, *supra* notes 178-83 and accompanying text, should not apply. See *Plantation Pipe Line Co. v. 3-D Excavators, Inc.*, 160 Ga. App. 756, 758-59, 287 S.E.2d 102, 105 (1981).

<sup>283</sup> See *Western Union Telegraph Co. v. Massman Construction Co.*, 402 A.2d 1275, 1277 (D.C. 1979); *Plantation Pipe Line Co. v. 3-D Excavators, Inc.*, 160 Ga. App. 756, 757, 287 S.E.2d 102, 104 (1981); *Kemp v. Hudnall*, 423 So. 2d 1260, 1262 (La. Ct. App. 1982); *St. Joseph Light and Power Co. v. Kaw Valley Tunnelling, Inc.*, 589 S.W.2d 260, 271-72 (Mo. 1979).

<sup>284</sup> See, e.g., *Plantation Pipe Line Co. v. 3-D Excavators, Inc.*, 160 Ga. App. 756, 757, 287 S.E.2d 102, 104 (1981) ("[a]ny damages to existing structures or utilities shall be repaired or made good by the Contractor at no expense to the owner"); *Kemp v. Hudnall*, 423 So. 2d 1260, 1261 (La. Ct. App. 1982) ("contractor . . . shall be responsible for all damage done to property or persons").

<sup>285</sup> See, e.g., *Lewis v. Globe Construction Co., Inc.*, 6 Kan. App. 2d 478, 486, 630 P.2d 179, 185 (1981); *Richmond Shopping Center, Inc. v. Wiley N. Jackson Co.*, 220 Va. 135, 142, 255 S.E.2d 518, 523 (1979).

tion of the promisee rather than create a direct obligation to the third party.<sup>286</sup>

The rule established in these cases, that a promise to compensate directly injured adjacent property owners will give rise to third party rights, lends itself to more expansive application. In the case of *Just's Inc. v. Arrington Construction Company*<sup>287</sup> the plaintiff sought damages not for injury to physical property but for loss of profits resulting from a blockage of traffic on the road leading to its business site. The construction contract included a clause requiring that continuous and adequate access to the businesses near the project be maintained.<sup>288</sup> The court concluded that this provision established an enforceable right in the businesses concerned.<sup>289</sup> In reaching this conclusion, the majority opinion<sup>290</sup> relied on precedent establishing third party standing based on property damage repair clauses.<sup>291</sup> Another extension of this line of reasoning is found in the case of *Leija v. Materne Bros., Inc.*<sup>292</sup> where the Washington Court of Appeals found that safety requirements in a road construction contract created third party rights in the traveling public, because the public would benefit from proper performance of the agreement. Although the court did not cite the property damage repair clause cases, it employed similar reasoning.<sup>293</sup>

<sup>286</sup> See, e.g., *Simons v. Tri-State Construction Co.*, 33 Wash. App. 315, 325, 655 P.2d 703, 709 (1983) ("In the instant case Tri-State did not agree to pay for or repair damage suffered by third parties nor did it agree to be liable for the potential damage. Tri-State agreed to indemnify and defend the City for liability claims, losses or damages.").

<sup>287</sup> 99 Idaho 462, 583 P.2d 997 (1978).

<sup>288</sup> *Id.* at 465, 583 P.2d at 1000. Among the relevant contract provisions was this paragraph: Business Access. The Contractor shall keep the businesses within the project area continuously advised of his proposed schedule of operations. Access to and from the various businesses shall be continuously and courteously provided. Movable pedestrian bridges, sturdily constructed and with adequate handrails, shall be provided where pedestrian access must be maintained over and across new concrete sidewalks, etc.

*Id.*

<sup>289</sup> *Id.* at 466, 583 P.2d at 1001. The court stated that:

[T]he contract provisions in the instant case obligated the defendant to take certain precautionary measures for the benefit of a limited class of third parties, the businesses within the [construction area]. Accordingly, members of that class of third party beneficiaries are entitled to sue for the defendant's alleged breach of those contract provisions.

*Id.*

<sup>290</sup> The two dissenting justices asserted that this contract was a "public works" contract and should be subject to rules limiting third party standing in government contract cases, citing *Moch v. Rensselaer*, 247 N.Y. 160, 159 N.E. 89 (1928) and RESTATEMENT OF CONTRACTS § 145 (1932) (see *supra* notes 178-79 and accompanying text). *Just's Inc.*, 99 Idaho at 471-72, 583 P.2d at 1006-1007 (Donaldson, Shepard, JJ., dissenting). The dissent went on to state that the majority ruling might open the door for numerous third party beneficiary suits, had misread the language of the contract, and was improper on policy grounds because the exposure to lawsuit would place an arduous burden on those contracting with the government. *Id.* at 473-75, 583 P.2d at 1008-10 (Donaldson, Shepard, JJ., dissenting).

<sup>291</sup> *Id.* at 466, 583 P.2d at 1001. The court cited *Yellowstone Pipe Line Co. v. Grant Construction Co.*, 95 Idaho 794, 795, 520 P.2d 249, 250 (1974) in which the court found that a promise to be "responsible" for damages gave rise to third party beneficiary rights in an injured property owner.

<sup>292</sup> 34 Wash. App. 825, 664 P.2d 527 (1983).

<sup>293</sup> *Id.* at 826, 664 P.2d at 529. The contract provided in part that the contractor would "be liable for injuries and damages to persons and property suffered by reason of the Contractor's operations or any negligence in connection therewith."

Although the court's language was not precise, it went on to find that third party beneficiary standing should be had by the traveling public which was intended to benefit from safety precautions. *Id.* at 829, 664 P.2d at 530.

An evaluation of the cases in this area reveals that standing has generally been limited to situations where a promise has been made for a direct performance or benefit to be received by the third parties. Only by virtue of liberal interpretation leading to a finding of such a promise have the courts enlarged the number of parties with standing. Such liberal interpretation reflects, however, a perceptible movement away from the presumption against third party standing and toward a position more in line with the principle that standing should be allowed whenever it is consistent with the contractual purposes and goals of the parties.<sup>294</sup>

### G. Real Property Transactions

Several parties regularly attempt to bring suit as third party beneficiaries of real property construction, sale, lease or financing agreements. Real estate brokers may bring suit for unpaid commissions;<sup>295</sup> lessors or lessees of property may bring suit for breach of the other parties' contracts;<sup>296</sup> and lenders may sue to protect their security interest<sup>297</sup> or may be sued if they fail to go forward on loan commitments.<sup>298</sup> The more significant cases

<sup>294</sup> See *supra* notes 45-49 and accompanying text. This principle is also embodied in Section 302 of the Restatement (Second) of Contracts, see *infra* notes 372-75 and accompanying text.

<sup>295</sup> Courts are not likely to find that the broker is a third party beneficiary of the seller-purchaser contract unless an express provision is included in the contract. Normally the broker has no action against the buyer and must pursue his action against the seller on the basis of the listing contract between them. See *Reidy v. Macauley*, 57 N.C. App. 184, 187, 290 S.E.2d 746, 748 (1982) (broker was not third party beneficiary of buyer-seller contract but must look to its listing contract with seller); *Tamposi Associates, Inc. v. Star Market Co., Inc.*, 119 N.H. 630, 633, 406 A.2d 132, 134 (1979) (broker was not third party beneficiary of lease agreement since he had his own contract with the lessor); *Professional Realty Corp. v. Bender*, 216 Va. 737, 739, 222 S.E.2d 810, 812 (1976) (broker was not third party beneficiary of buyer-seller contract in absence of provision permitting recovery against buyer; outcome would be different if purchaser had promised commission upon his default); cf. *Maganas v. Northrup*, 135 Ariz. 573, 576, 663 P.2d 565, 568 (1982) (en banc) (broker and his salesman were third party beneficiaries where contract expressly provided for commission); *Dworak v. Michaels*, 211 Neb. 716, 724, 320 N.W.2d 485, 489 (1982) (broker was third party beneficiary of agreement between seller and multi-listing service which specifically provided for broker's commission).

<sup>296</sup> Lessors and lessees are generally not deemed third party beneficiaries of the others' contracts with third parties. See *American Financial Corp. v. Computer Sciences Corp.*, 558 F. Supp. 1182, 1185-86 (D. Del. 1983) (lessor of computers was not third party beneficiary of maintenance agreement between lessee and third party); *Fourth & Main Co. v. Joslin Dry Goods Co.*, 648 P.2d 178, 181 (Colo. Ct. App. 1982) (fellow lessees were not third party beneficiaries of lessor's separate lease with anchor store); *Wing v. Amalgamated Sugar Co.*, 684 P.2d 307, 311 (Idaho Ct. App. 1984) (lessor of farm was not third party beneficiary of lessee-grower's contract for the sale of crops produced on the farm); *Hardware Center Inc. v. Parkedge Corp.*, 618 S.W.2d 689, 693 (Mo. Ct. App. 1981) (sublessee was not third party beneficiary of provisions in original lease other than the provision allowing for sublease); *May's Family Centers Inc. v. Goodman's Inc.*, 571 F. Supp. 1012, 1015-16 (N.D. Ill. 1983) (applying Illinois law) (sublessee was third party beneficiary of original lease provision allowing for sublease).

<sup>297</sup> See *First National State Bank of New Jersey v. Commonwealth Federal Savings and Loan*, 610 F.2d 164, 170-71 (3d Cir. 1980) (permanent lender did not have third party standing on agreement between borrower and interim lender concerning limits on use of interim funds); *Illinois Housing Development Authority v. M-Z Construction Corp.*, 110 Ill. App. 3d 129, 137-41, 441 N.E.2d 1179, 1184-88 (1982) and *Illinois Housing Development Authority v. Sjostrom & Sons, Inc.*, 105 Ill. App. 3d 247, 258-59, 433 N.E.2d 1350, 1358-59 (1982) (both cases concluding that state agency-mortgagee was not third party beneficiary of contracts between owner and contractors in construction of housing financed under state plan).

<sup>298</sup> See *Dale v. Groebe & Co.*, 103 Ill. App. 3d 649, 653, 431 N.E.2d 1107, 1111 (1981) (seller of

in this area, however, concern the possible standing of the purchaser of a home against a remote builder<sup>299</sup> or some other party who provides a service in the overall transaction, such as an appraiser, surveyor, or title agency.<sup>300</sup> Also closely related are cases involving not a purchaser but a tenant or lessee who holds a particularly important role in a construction or sales transaction.<sup>301</sup>

### 1. Remote Home Builder Cases

The remote builder cases generally involve a purchaser who buys a new home from a developer-seller and later wishes to bring suit against the builder of the home for breach of his contract with the developer due to some flaw in construction. The Illinois case of *Altevogt v. Brinkoetter*<sup>302</sup> posed such a situation. In that case the Illinois Supreme Court denied the purchaser standing as third party beneficiary because of a lack of intent by the contracting parties to confer a "direct benefit" on the purchaser.<sup>303</sup> The court acknowledged the widely recognized rule that a third party need not be named in a contract or even be specifically known to have standing on a contract<sup>304</sup> but gave more weight to the countervailing principle that mere knowledge by the builder that the house would be resold by the developer is not enough to confer third party rights on the future purchaser.<sup>305</sup> Other courts applying Illinois law have reached consistent decisions.<sup>306</sup> These cases would seem to require an express statement of intent to create third party rights in an ultimate purchaser.

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land was not third party beneficiary of loan commitment agreement between purchaser and bank); *Khabbaz v. Swartz*, 319 N.W.2d 279, 285-86 (Iowa 1982) (same).

<sup>299</sup> See, e.g., *Waterford Condominium Ass'n v. Dunbar Corp.*, 104 Ill. App. 3d 371, 372, 432 N.E.2d 1009, 1010 (1982); *Hillbrook Apartments, Inc. v. Nyce Crete Co.*, 237 Pa. Super. 565, 569, 352 A.2d 148, 150 (1975).

<sup>300</sup> See, e.g., *Brown v. Summerlin Associates, Inc.*, 272 Ark. 298, 299, 614 S.W.2d 227, 228 (1981) (contract to survey land); *Hines v. Amole*, 4 Ohio App. 3d 263, 263, 448 N.E.2d 473, 474 (1982) (contract for termite inspection).

<sup>301</sup> See *Seiler v. Levitz Furniture Co.*, 367 A.2d 999, 1001 (Del. 1976); *People ex rel. Resnik v. Curtis & Davis, Architects and Planners, Inc.*, 78 Ill. 2d 381, 382, 400 N.E.2d 918, 918 (1980); *Pennsylvania Liquor Control Board v. Rapistan, Inc.*, 472 Pa. 36, 40, 371 A.2d 178, 180 (1976).

<sup>302</sup> 85 Ill. 2d 44, 421 N.E.2d 182 (1981).

<sup>303</sup> *Id.* at 56, 421 N.E.2d at 188.

<sup>304</sup> *Id.* at 55, 421 N.E.2d at 187.

<sup>305</sup> *Id.* at 56-57, 421 N.E.2d at 188:

The plaintiffs point to the allegation of paragraph 6 that Hinton [the builder] knew that the house was not to be occupied by Brinkoetter [the developer] but would be offered for sale to other persons. We note initially the absence of any allegation that Brinkoetter had informed Hinton that such was his intention prior to the execution of the contract. Apart from that consideration, we do not believe that Hinton's knowledge that a third party would occupy the house establishes that the plaintiffs were direct beneficiaries.

*Id.* (citing *Rozney v. Marnul*, 43 Ill. 2d 54, 250 N.E.2d 656 (1969) (surveyor not liable to third party purchasers even though he knew others would rely on the survey report)).

<sup>306</sup> See *Waterford Condominium Ass'n v. Dunbar Corp.*, 104 Ill. App. 3d 371, 373, 432 N.E.2d 1009, 1011-12 (1982) (purchasers and their association were not third party beneficiaries of contract between developer and defendant-sellers for construction of condominiums). *Accord* *Slate Printing Co. v. Metro Envelope Co.*, 532 F. Supp. 431, 433-34 (N.D. Ill. 1982) (mere knowledge that paper goods would be sold to an ultimate purchaser is not enough under Illinois law to create third party beneficiary rights); *Spiegel v. Sharp Electronics Corp.*, 466 N.E.2d 1040, 1045 (Ill. 1984) (mere knowledge that photocopiers would be resold by distributor to ultimate buyer did not create third party beneficiary rights against original vendor).

The Illinois Supreme Court, however, had decided in a case antedating *Altevogt* that, in essence, an express statement of intent to create third party rights in an ultimate purchaser is not required. In that case, *People ex rel. Resnik v. Curtis & Davis*,<sup>307</sup> the contract between the builder and the owner clearly and expressly indicated that the building and facilities were being constructed for use by the State of Illinois as a prison but did not include an explicit statement that third party rights were created in favor of the State.<sup>308</sup> The court concluded that "[c]onstruction of the prison would directly benefit the State, the 'User' — not the parties; . . . the State is a proper party plaintiff because it is a direct beneficiary clearly identified and intended in the contract before us."<sup>309</sup> The court concluded that the State was a direct beneficiary because (1) the State would occupy and use the buildings and (2) because that fact was acknowledged in the contract.<sup>310</sup> If standing was granted for those reasons, a third party purchasing a home in a new subdivision development would seem to hold a similar status because (1) the unknown purchaser, not the developer, will occupy and use the home, and (2) the surrounding circumstances of the developer-builder contract undeniably acknowledge that a future purchaser will become the user of the home. The fact that the particular purchaser is not known should not make a difference and neither should the fact that the intent to resell is derived from circumstances rather than the contract itself.

The *Altevogt* case was decided after *Resnik* and the court did consider the possibility that the earlier case was controlling precedent. The court, however, viewed the facts of *Resnik* as including sufficient indications of intent to create third party rights in the State even though an express statement was lacking.<sup>311</sup> The *Altevogt* court specifically acknowledged that an unknown future purchaser of a home in a subdivision might acquire the same kind of rights as the tenant in *Resnik* but indicated that something more than the developer's obvious intent to resell the home is required.<sup>312</sup> On the other hand, *Resnik* must be read to mean that something less than an express statement to that effect will suffice. It is difficult to imagine, as a practical matter, what sort of nonexpress indications would have satisfied the *Altevogt* court that an unknown future purchaser should acquire third party rights.

Further study of the *Altevogt* and *Resnik* cases yields additional skepticism about their consistency. One could conclude that the future unknown purchaser in *Altevogt* was more

<sup>307</sup> 78 Ill. 2d 381, 400 N.E.2d 918 (1980).

<sup>308</sup> *Id.* at 385-86, 400 N.E.2d at 920.

<sup>309</sup> *Id.* at 386-87, 400 N.E.2d at 920. The state was not a direct party because of a limitation placed on the state's budget deficit by the state constitution. By establishing the Illinois Building Authority to contract for the prison and then lease it to the state the budget limit was circumvented. *Id.* at 386, 400 N.E.2d at 920.

<sup>310</sup> A decision similar to that in *Resnik* was reached in *Seiler v. Levitz Furniture Co.*, 367 A.2d 999 (Del. 1976). The owner contracted to build a commercial building specifically for the tenant, Levitz Furniture Company. Levitz was found to be a third party beneficiary of the contract between the architect and owner to plan a building to meet the known tenant's requirement. *Id.* at 1007. *Cf.* *Chmielewski v. City Products Corp.*, 660 S.W.2d 275, 289 (Mo. Ct. App. 1983) (special sublessee who was intended to benefit by lessee but not made known to owner-lessor could not qualify as third party beneficiary).

<sup>311</sup> *Altevogt*, 85 Ill. 2d at 55, 421 N.E.2d at 187.

<sup>312</sup> *Id.* at 56, 421 N.E.2d at 187. The Supreme Court stated that the appellate court had erred to the degree that its denial of third party standing rested on the lack of identification of the particular purchasers in the contract, and the court specifically acknowledged that a developer might indeed intend to confer a right on purchasers but indicated that the developer's intent must be shown on some basis other than his well-known plan to resell the homes. *Id.* at 55-56, 421 N.E.2d at 187-88.

correctly a direct beneficiary than the known tenant in *Resnik*. Both parties occupied the respective buildings but the purchaser in *Altevogt* had a substantial permanent investment in the home. In contrast, the tenant-user in *Resnik* could refuse to perform under its lease arrangement with the owner if the building failed to meet its structural specifications. Moreover, a tenant can almost always pursue an action against the owner in the event of breach, while the same cannot be said of a purchaser of a home with respect to a developer. In both of these types of cases a court could, and perhaps should, find that multiple parties stand to receive an intended direct benefit from the construction contract. In the *Resnik* type of case, both the owner and the tenant benefit from a properly constructed building; in the *Altevogt* type of case, the developer will receive the benefit of having the home properly constructed and available for resale and the future purchaser will have the benefit of a properly constructed, habitable home. Both parties benefit, albeit successively, in an intended, direct and substantial manner.

These cases should be distinguished from the situation where the contractual performance is clearly for some purpose other than to benefit the third party purchaser. *Mogensen v. Martz*<sup>313</sup> offers an example of this latter situation. That case involved a contract between the seller of land and a construction company for the latter to perform a variety of tasks on the land, including removal of tree stumps. The purpose of the contract was to repair and maintain a system of drain pipes.<sup>314</sup> The subsequent purchaser of the land, who intended to conduct farming activities, discovered that the tree stumps had not been removed and that the land was not tillable. Because the purpose of the contract was not to make the land tillable for the purpose of resale to farmers, the court correctly denied the purchaser third party standing on the maintenance contract.<sup>315</sup> If the owner had sought to make the land tillable to sell it to an unknown farmer, and the construction company had been aware or had had reason to know of this intent, then third party rights probably should have been deemed to exist in the ultimate purchaser.

A final point should be made about the remote builder cases. Illinois courts, in light of the *Resnik* and *Altevogt* decisions, would seem likely to grant third party rights on a construction contract where a developer had a custom home built for a known ultimate purchaser, even without an express statement of intent to create rights, but would not be likely to grant such rights to an unknown future purchaser who contracts to buy a home even as early as the day after the construction contract is entered into by the developer and builder.<sup>316</sup> The distinction between the two purchasers seems hardly significant and is undeniably related to the identity of the purchaser-third party being known at the time of contracting, a factor which the Illinois Supreme Court has stated should not be determinative.<sup>317</sup>

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<sup>313</sup> 441 N.E.2d 34 (Ind. 1982).

<sup>314</sup> *Id.* at 34.

<sup>315</sup> *Id.* at 35.

<sup>316</sup> Indeed, in *Altevogt* the contract to purchase the home was apparently entered into while the home was still under construction and the developer agreed to have completed certain construction requirements imposed by the purchaser. 85 Ill. 2d at 47-48, 421 N.E.2d at 183-84. The fact that the purchaser becomes known even while construction is in progress would not call for a different outcome by the *Altevogt* court since Illinois law requires that the requisite indicia of intent be present at the time the contract is executed, not some time thereafter. *F.W. Hempel & Co., Inc. v. Metal World, Inc.*, 721 F.2d 610, 613-14 (7th Cir. 1982) (applying Illinois law).

<sup>317</sup> *Altevogt v. Brinkoetter*, 85 Ill. 2d 44, 55, 421 N.E.2d 182, 187 (1981) ("It is not necessary that a contract for the benefit of a third party identify him by name. The contract may define a third party by description of a class, and it is sufficient if [he] may be identified at the time performance is due as a member of the class to be benefitted.") (citations omitted).

## 2. Real Estate Appraisal, Inspection, and Surveying Cases

In the variety of real property transaction cases which focus not on home construction contracts but on contracts for inspection, surveying, appraisal or other services related to the sale of homes, the purchaser is often denied standing, but for different reasons than those given in the remote builder cases analyzed in the previous section. This distinction results in large part because the prospective purchasers in these cases are generally known and identified. In the related services cases, the decisive factor for the courts which grant standing seems to be knowledge by the contracting parties that the purchaser will benefit from the service. Such knowledge will be sufficient to create third party rights without an express statement to that effect.<sup>318</sup> In the case of *Stollar v. Hester*,<sup>319</sup> for example, the New Mexico Court of Appeals reversed a trial court decision granting summary judgment to an appraiser who was sued by the purchasers of a home. The purchasers alleged that the appraisal was erroneous and caused them to suffer damages.<sup>320</sup> The appraiser had been employed by the sellers and conflicting evidence was presented as to whether the sellers indicated that the purpose of the appraisal was to facilitate the sale of the home or merely to refinance the sellers' mortgage.<sup>321</sup> The appeals court concluded that the purchasers would be third party beneficiaries if it could be shown that the sellers intended the purchasers to benefit from the appraisal and the appraiser had reason to know of that intent.<sup>322</sup>

The difficulty that purchasers encounter in these types of cases is that courts are often inclined to conclude that the purpose of the service contract is not to benefit the purchaser of the home. An example of this reasoning is found in *Atva v. Cloninger*,<sup>323</sup> a 1981 North Carolina decision which also involved a presale appraisal of a home. The appraiser had been hired by the lending institution<sup>324</sup> and he returned a favorable report on the home. After moving into the home the purchasers found serious structural defects related to a "slope" in the house; the home apparently had been built on a land fill and the settling had caused the home to slant in a manner that created a variety of problems.<sup>325</sup> Although testimony was offered that the appraised value was grossly erroneous and that the appraiser should have discovered the defects,<sup>326</sup> the court denied the purchasers

<sup>318</sup> See *Brown v. Summerlin Associates, Inc.*, 272 Ark. 298, 300, 614 S.W.2d 227, 229 (1981) (special master's finding that purchaser was not third party beneficiary of survey contract between seller and defendant was not clearly erroneous and therefore not reversible, but basis for finding third party standing existed and the court, if it were seized with question, might have done so); *Hines v. Amole*, 4 Ohio App. 3d 263, 268, 448 N.E.2d 473, 479 (1982) (purchasers were third party beneficiaries of termite inspection contract between inspector and realtor acting as agent for seller).

<sup>319</sup> 92 N.M. 26, 582 P.2d 403 (N.M. Ct. App. 1978).

<sup>320</sup> *Id.* at 31, 582 P.2d at 408. The purchasers alleged they were damaged in that the appraisal reported the wrong square footage and failed to allocate a deduction for poor roof condition. *Id.*

<sup>321</sup> *Id.* at 30-31, 582 P.2d at 407-08.

<sup>322</sup> *Id.* The court stated, "to be third party beneficiaries, [the appraiser] must have had reason to know that the [sellers] intended such a benefit for prospective purchasers of their property. This intent may be shown by extrinsic evidence if not stated in the contract." *Id. Accord* *Stagen v. Stewart-West Coast Title Co.*, 149 Cal. App. 3d 114, 119, 196 Cal. Rptr. 732, 735 (1983) (in dictum court stated that when abstractor knows that abstract is for third person liability will arise).

<sup>323</sup> 51 N.C. App. 602, 277 S.E.2d 535 (1981).

<sup>324</sup> *Id.* at 604, 277 S.E.2d at 537-38. The purchaser paid the cost of the appraisal to the lender who then entered into the contract for the appraisal. *Id.*

<sup>325</sup> *Id.* at 604-05, 277 S.E.2d 537-38. Among the problems were cracks and bumps in the floor and doors which closed themselves. *Id.*

<sup>326</sup> *Id.* at 605-06, 277 S.E.2d 537-38. Testimony of three other appraisers indicated that the

standing in their suit against the appraiser.<sup>327</sup> The court reasoned that the lender had requested the appraisal for the limited purpose of assisting in its processing of the loan application and that the purchasers received a merely incidental benefit from the appraisal to the extent that it affected the lender's decision to grant or deny the loan.<sup>328</sup> These grounds for denying standing in *Alva* and other similar cases<sup>329</sup> are phrased in a manner consistent with most third party beneficiary rules. That is, courts reason that the contracting parties' purpose for the service performed involved a direct benefit or performance to someone other than the purchaser of the realty.

Thinking critically about the reasoning in the *Alva* case, one recognizes that a lender could conceivably hire its own appraiser entirely for its own internal evaluation and assume responsibility for the correctness of the appraisals. This type of arrangement would be tantamount to appraisal conducted by the lender's employee. Third party rights would most certainly not arise out of this type of arrangement because the circumstances would deny any basis for contemplating direct liability by the appraiser to the purchaser. Actual cases, however, present a different situation. The appraiser and the lender contract with an acute awareness that the purchaser's transaction will be greatly and directly affected by the appraisal. Not only is the appraiser's report a factor in the lender's decision, but the report also undeniably influences the purchaser's overall transaction. A strong argument can be made that, where the appraiser is aware that an appraisal is required in connection with the sale of realty, the purchaser is intended to derive a direct and substantial benefit from proper performance of the contract for appraisal services and therefore is entitled to third party beneficiary standing. This is the type of reasoning used by the court in *Stollar v. Hester*<sup>330</sup> and seems to be consistent with other types of cases emphasizing direct benefit and performance as a basis for finding third party rights as discussed throughout this review of recent decisions.<sup>331</sup>

### III. CONSTRUING SECTION 302 OF THE RESTATEMENT (SECOND) OF CONTRACTS

The rule found in Section 133 of the Restatement of Contracts<sup>332</sup> on third party beneficiary rights has been widely accepted by the courts.<sup>333</sup> The courts have been notably

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defects should have been discovered at the time of the appraisal and that the value of the property should have been \$38,500 instead of the \$53,500 value assigned in the original appraisal. *Id.*

<sup>327</sup> *Id.* at 608-09, 277 S.E.2d at 539.

<sup>328</sup> *Id.* at 608, 277 S.E.2d at 539.

<sup>329</sup> See *Norton v. First Federal Savings*, 128 Ariz. 176, 178, 624 P.2d 854, 856 (1981) (en banc) (purchasers were not third party beneficiaries of developer's performance bond required by city to guarantee construction of streets, sewers, water line and other improvements; city required bond to protect itself from the cost of improvements if developer refused or defaulted in performance); *Walters v. Marler*, 83 Cal. App. 3d 1, 33, 147 Cal. Rptr. 655, 675 (1978) (purchaser was not third party beneficiary of contract between lender and insurance company for insurance title report because sole purpose of insurance contract was to protect lender against impairment of security); *Mary Ellen Sandlie Trust v. Pioneer National Title Ins. Co.*, 648 S.W.2d 761, 762 (Tex. Civ. App. 1983) (purchaser was not third party beneficiary of contract for title report; report was not to be issued to purchaser but to be used in writing title insurance policy).

<sup>330</sup> See *supra* notes 319-22 and accompanying text.

<sup>331</sup> See *supra* notes 123-330 and accompanying text.

<sup>332</sup> See *supra* note 12 for text of Section 133.

<sup>333</sup> Connecticut appears to be the only state expressly rejecting the Restatement of Contracts Section 133 rule on third party rights. See *Data General Corp. v. Citizens National Bank*, 502 F. Supp. 776, 785 (D. Conn. 1980) (citing *Colonial Discount Co. v. Avon Motors, Inc.*, 137 Conn. 196, 200-02, 75 A.2d 507, 510 (1950)). The Connecticut test is simply "whether the intent of the parties to the

slow to accept and adopt Section 302 of the Restatement (Second) of Contracts as a replacement for the earlier standard.<sup>334</sup> Nonetheless the newer formulation has begun to gain increasing importance in light of its adoption as reflecting the law, at least in part, in Massachusetts, Minnesota, and Pennsylvania.<sup>335</sup> Section 302 has also been commented on or construed in the opinions of several federal courts as well as courts in at least eleven other jurisdictions.<sup>336</sup> A review of those cases where Section 302 has been cited would quickly reveal that the courts are not in agreement on whether or in what manner Section 302 differs from Section 133 and other pre-existing rules on third party beneficiary standing.<sup>337</sup>

The conflicting readings of Section 302 reveal a present need for a careful interpretation to determine how its rule should be applied. A proper assumption would undoubtedly be that the drafters intended the section to improve and clarify the Section 133 formulation.<sup>338</sup> Its natural goals, therefore, would be to preserve the better part of the existing rules and their applications and to effect changes that would encourage courts to eliminate inconsistencies both within and among the various jurisdictions. Using the original Section 133 as a point of reference, the substance of Section 302 and its available drafting history will be reviewed to ascertain the hard or certain changes built into it, the deficiencies in the section, and those areas where the section is pliable and lends itself to a useful interpretation.

#### A. The Drafting History of Section 302

The original Restatement of Contracts formulation on third party beneficiary standing was framed in a manner which comported with contemporary court rules on the rights of third party beneficiaries.<sup>339</sup> The Restatement served only to identify a consensus norm rather than establish an ideal rule.<sup>340</sup> As such, the formulation necessarily suffered from many of the same deficiencies present in the judicial formulations and it fell short of serving as an optimal guide to practitioners and courts in the period following publication of the first Restatement, a period during which this relatively new basis for claimant standing was given an increasing application.<sup>341</sup>

In addressing Section 133 during the drafting of the Restatement (Second) of Contracts, the American Law Institute (ALI) participants were keenly aware of the

contract was that the promisor should assume a direct obligation to the third party." *Id.* The court in *Colonial Discount*, while maintaining the distinction between its test and Section 133, surmised that, as a practical matter, the difference was more apparent than real. 137 Conn. at 202, 75 A.2d at 510.

See RESTATEMENT (SECOND) OF CONTRACTS, Volume IV-Appendix at 349-85 (1981 & Supp. 1983) for cases reflecting states either adopting or favorably citing Section 133.

<sup>334</sup> The current version of Section 302 first appeared in draft form in 1973. The complete Restatement (Second) of Contracts was completed in 1979. See *supra* note 12. Only Massachusetts, Pennsylvania and Minnesota have expressly adopted the Section 302. See *supra* notes 25-27. The reaction of other states is included in the Appendix to this article, *infra*.

<sup>335</sup> See *supra* notes 25-27 and accompanying text.

<sup>336</sup> See *infra* Appendix.

<sup>337</sup> See *infra* Appendix.

<sup>338</sup> See Farnsworth, *Ingredients in the Redaction of the Restatement (Second) of Contracts*, 81 COLUM. L. REV. 1, 5-6 (1981) (citing Wechsler, *The Course of the Restatements*, 55 A.B.A. J. 147, 149-51 (1969)).

<sup>339</sup> See E. FARNSWORTH, CONTRACTS § 10.2 (1982).

<sup>340</sup> See 4 A. CORBIN, CONTRACTS § 772 (1951).

<sup>341</sup> A very succinct history of contract third party beneficiary law is found in E. FARNSWORTH, CONTRACTS § 10.2 (1982). The recognition of third party rights in American courts apparently first became noticeable in the mid-19th century. *Id.*

difficulties encountered by the courts in attempting to differentiate between those third party beneficiaries with standing to enforce a promise and those lacking such standing. Indeed, the Reporter<sup>342</sup> for the ALI indicated in one instance that the revision of Section 133 was "one of the more dramatic changes" made in drafting the Restatement (Second).<sup>343</sup> This section was apparently the only one to have been discussed in more than one annual meeting of the ALI.<sup>344</sup> Despite the basic changes in terminology,<sup>345</sup> an analysis of the revision and the present reaction of the courts strongly indicate that the changes were not so substantial or obvious as to provide clear and immediate help for the courts where help was, and still is, indisputably needed.

The deficiencies in the revision of Section 133 may have resulted in large part from the conservative approach of the ALI in revising the Restatement of Contracts. In identifying the spirit of the revising drafters, the Reporter indicated that the participants had "handled the original Restatement tenderly, as befits a classic."<sup>346</sup> This approach was generally warranted, considering that the Restatement of Contracts was the first restatement completed and had enjoyed tremendous success.<sup>347</sup> In the instance of the third party beneficiary rights, however, the new drafters may have been remiss in not making a greater departure from the first Restatement.

The definition of third party beneficiaries contained in Section 133 of the original Restatement required that the putative beneficiary be classified as a creditor, donee or incidental beneficiary.<sup>348</sup> The essence of the creditor category was that the promisor's performance to the third party should satisfy some duty owed by the promisee to the third party.<sup>349</sup> The donee category not only encompassed those instances in which an apparent purpose on the part of the promisee to make a gift to the third party was present, but also included a "catchall" class of situations where neither a duty to the third party nor a true donative intent was present but still an apparent purpose to confer upon the third party some right to performance from the promisor could be found.<sup>350</sup>

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<sup>342</sup> The reporter for the Restatement (Second) of Contracts during the relevant time period was the late Judge Robert M. Braucher of Massachusetts. For an account of the contribution of Judge Braucher, see Von Mehren, *Preface: Robert Braucher and the Restatement (Second) of Contracts*, 67 CORNELL L. REV. 631 (1982).

<sup>343</sup> 44 ALI Proceedings 304 (1967).

<sup>344</sup> The discussion of Section 133 began in the 1967 meeting, 44 ALI Proceedings 304-14, and was concluded in the 1969 meeting, 46 ALI Proceedings 330-31.

<sup>345</sup> The major change in new Section 302 was the abandoning of the creditor and donee categorization distinction. See 44 ALI Proceedings 304 (1967); RESTATEMENT (SECOND) OF CONTRACTS § 302, Reporter's Note-Volume II at 445 (1981). For text, see *supra* note 12.

<sup>346</sup> 44 ALI Proceedings 304 (1967). See also RESTATEMENT (SECOND) OF CONTRACTS, FOREWORD-Volume I at VII (1981):

The Reporters, their Advisers and the Institute approached the first Restatement with the respect and tenderness that are appropriate in dealing with a classic. As the work proceeded it uncovered relatively little need for major substantive revision, in the sense of changing the positions taken on important issues although the Uniform Commercial Code inspired a number of significant additions.

*Id.*

<sup>347</sup> See Farnsworth, *Ingredients in the Redaction of the Restatement (Second) of Contracts*, 81 COLUM. L. REV. 1, 1-2 (1981).

<sup>348</sup> See *supra* note 12 for text of Section 133.

<sup>349</sup> The creditor category included not only actual obligations but also supposed or asserted obligations and obligations that may have been barred by statutes of limitation, by discharge in bankruptcy, or by the Statute of Frauds. RESTATEMENT OF CONTRACTS § 133(1)(b) (1932), *supra* note 12.

<sup>350</sup> RESTATEMENT OF CONTRACTS § 133(1)(a) and comment c (1932).

The revising drafters saw significant problems in the donee and creditor categorizations.<sup>351</sup> Such categorization problems were the principal reason for the revision of this section.<sup>352</sup> According to the Reporter, the "catchall" provision of the donee definition included instances where the "donee" label was entirely inappropriate.<sup>353</sup> The Reporter also indicated a similar problem with the creditor class in that it included not only persons who truly stood as creditors, that is, persons to whom a debt was owed by the promisee, but also others who were merely owed a "supposed" or "asserted" duty or obligation by the promisee and therefore were not creditors in the usual sense.<sup>354</sup>

The categorization problem thus appears to have been the primary motive for revising the formulation of Section 133. This revision consisted in large part of changing from the creditor and donee categories to a single description of persons having rights as "intended" beneficiaries.<sup>355</sup> Only while attempting to define the new intended beneficiary category did the drafters begin to focus on the more significant problem faced by the courts in applying Section 133 and similar rules, that is, the determination of standards for deciding when there is sufficient indicia of the parties' intent to benefit to justify granting a third party standing to enforce the promise.<sup>356</sup>

In the ensuing discussion,<sup>357</sup> the Reporter observed that the "basic spirit" of this

<sup>351</sup> See RESTATEMENT (SECOND) OF CONTRACTS, Chapter 14 — Introductory Note-Volume II at 438-39 (1981) ("[S]ince the terms 'donee' beneficiary and 'creditor' beneficiary carry overtones of obsolete doctrinal difficulties, they are avoided in the statement of rules in this chapter.").

<sup>352</sup> 44 ALI Proceedings 305-07 (1967). Another reason for and consequence of removing the creditor-donee distinction was the elimination the distinction made between the two groups as to the time when rights would vest in a third party beneficiary. *Id.* See also RESTATEMENT (SECOND) OF CONTRACTS § 311, Reporter's Note-Volume II at 469 (1981); E. FARNSWORTH, CONTRACTS § 10.6 (1982).

<sup>353</sup> 44 ALI Proceedings 305 (1967). The reporter stated:

[I]f you look at 133, subsection (1)(a), the last four lines include the case where there is no intention to make a gift at all, and where the word donee is entirely inappropriate. This happens in cases, for example, of construction bonds for the benefit of laborers and materialmen, where the promisee of the bonds has no direct contractual connection with the beneficiaries, but it is not at all a gift situation. It comes up again in the mortgagee case, where land subject to a mortgage is transferred to a succession of grantees, and among the grantees there is a grantee who does not assume and agree to pay the mortgage debt. In such a case, if there is then a later promise to assume and pay the mortgage debt, you have, I think what might well be within (1)(a), the case where there is an intention to confer upon the beneficiary a right to some performance, neither due nor supposed or asserted to be due from the promisee to the beneficiary, but there would be no appropriateness in the word gift or in the word donee as applied to that situation.

<sup>354</sup> *Id.* at 306 ("where the promise is to pay a supposed or asserted debt, . . . then it's very doubtful whether that is properly described as a creditor beneficiary. It's a non-creditor beneficiary.").

<sup>355</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 133 (Tentative Draft No. 3, April 18, 1967). The 1967 draft was as follows:

§ 133. Intended and Incidental Beneficiaries. (1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if (a) the performance of the promise will satisfy a duty of the promisee to the beneficiary; or (b) the promisee manifests an intention to give the beneficiary the benefit of the promised performance and recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties. (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

<sup>356</sup> See text accompanying notes 97-122, *supra*.

<sup>357</sup> 44 ALI Proceedings 307-14 (1967).

section, both in the original and in the revised Restatements, was that the "manifested intent" of the parties, rather than their "actual intent," ought to determine who "get[s] rights by virtue of a promise between two other parties."<sup>358</sup> In determining what indicia of manifested intent should be sufficient for this purpose, the drafters unfortunately chose to return, in large part, to the creditor and donee categories, merely omitting those labels.<sup>359</sup> An "intended" beneficiary was described in revised Section 133(1)(a), as presented in the 1967 discussions, as what amounted to a narrowed, true creditor class.<sup>360</sup> In other words, revised Section 133(1)(a) was drafted to give standing to a third party who is owed an actual duty by the promisee and is to receive from the promisor a performance which would satisfy that duty.<sup>361</sup> Revised Section 133(1)(b) generally corresponded with the donee description contained in former Section 133 in that it included as "intended" beneficiaries all parties to whom the promisee manifests an intent to give the benefit of the promisor's performance.<sup>362</sup> The only real change in the donee definition was the inclusion of those classified as quasi-creditors under the former rule.<sup>363</sup> The change in labeling was primarily addressed to "gap" or miscategorization problems due to the difficulty in identifying parties as creditors or donees.<sup>364</sup> Such problems, however, were more apparent than real, since the courts applying the original formulation were able, with few exceptions, to overcome the risk of miscategorization.<sup>365</sup> The real difficulty that courts encountered was in establishing clear standards for determining whether sufficient evidence of the parties' intent to benefit was present to qualify a third party as a donee beneficiary within the categorization test.<sup>366</sup>

The new formulation addressed this latter difficulty only to a limited extent. The Reporter indicated that the chronic problems in establishing standards of intent were addressed by the change in the language defining the enlarged donee class.<sup>367</sup> This definition was changed from a requirement in original Section 133(1)(a) that the promisee intend to make a gift to the beneficiary or to confer upon him a right to performance<sup>368</sup> to a requirement that the promisee "manifest an intent to give the benefit" and that

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<sup>358</sup> *Id.* at 307.

<sup>359</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 133(1)(a) and (b) (Tentative Draft No. 3, April 18, 1967), text *supra* note 355; see also RESTATEMENT (SECOND) OF CONTRACTS § 302, comments b and c (1981).

<sup>360</sup> RESTATEMENT (SECOND) OF CONTRACTS § 133(1)(a) (Tentative Draft No. 3, April 18, 1967), text *supra* note 323. The section would no longer encompass those claimants with mere asserted, supposed or barred obligations. See *supra* note 317. The reporter described the remainder with *actual* obligations as the "hard core creditor beneficiary cases." 44 ALI Proceedings 307 (1967).

<sup>361</sup> This rule would be subject to the obvious limit that the parties may expressly agree not to create rights in a third party. See *supra* note 63.

<sup>362</sup> RESTATEMENT (SECOND) OF CONTRACTS § 133(1)(b) (Tentative Draft No. 3, April 18, 1967), text *supra* note 355.

<sup>363</sup> See 44 ALI Proceedings 307 (1967). The reporter stated "we put all the others [other than hard core creditors] together in (1)(b)."

<sup>364</sup> See *supra* notes 102-07 and accompanying text.

<sup>365</sup> See *supra* notes 102-19 and accompanying text.

<sup>366</sup> See *supra* notes 119-22 and accompanying text.

<sup>367</sup> 44 ALI Proceedings 307 (1967). By virtue of narrowing the creditor class to the hard core creditor cases, *supra* note 360, the revised section established that intent would be deemed present if the creditor relationship could be objectively established and the parties had not expressly provided otherwise. The intent problem then primarily would relate only to non-creditor circumstances where the intent cannot be established by an objectively provable relationship among the parties. See *supra* notes 119-22 and accompanying text.

<sup>368</sup> RESTATEMENT OF CONTRACTS § 133(1)(a) (1932), text *supra* note 12.

recognition of a right to performance be appropriate to "effectuate" the common intent of the contracting parties.<sup>369</sup> This change was meant to suggest that the requisite proof of intent ought to be the "more factual indicia."<sup>370</sup> The new definition emphasized "manifest" rather than "actual," but unspoken, purpose, or intent.<sup>371</sup> The drafters apparently took the view that problems in applying the donee definition could be relieved by looking for objective rather than subjective indicia of intent.

The change in the donee definition was also designed to address the related question of whether gap filling is appropriate in this area.<sup>372</sup> The drafters noted that parties often do not actually consider whether or not the third party beneficiary should have legal standing to pursue a right to performance.<sup>373</sup> The revised Restatement section, therefore, is not structured to require that there be some actual contemplation of third party rights by the contracting parties, with a consequent denial of standing if such actual intent cannot be found. The section is rather intended to provide a standard to determine whether third party standing is consistent with the goals of the parties when they have failed to provide for it explicitly in the contract.<sup>374</sup> It is notable that in this respect the revised definition does not embody any presumption against third party rights, contrary to most state rules.<sup>375</sup>

The emphasis on manifest or objective evidence of intent in the drafting history of the revised section suggests a realistic perception of the courts' function in deciding third party beneficiary cases. Neither the text, the commentary, nor the illustrations or any other portions of the revised section, however, go very far toward establishing clear norms for deciding when a sufficient basis exists in the manifest intent of the parties to warrant third party standing. The one clear exception to the foregoing statement is found in the case where the promisor assumes an obligation to satisfy an actual money debt owed by the promisee to the third party.<sup>376</sup> In this narrow, true creditor situation, third party rights are presumed. In all other cases, the section fails to address the difficulties experienced by the courts in evaluating the sufficiency of the parties' intent.

As has been suggested,<sup>377</sup> the change in Section 133 was only a minimal change. The change in terminology not only failed to address adequately the major problem of the intent standard, but also, as the ALI participants themselves acknowledged, failed to

<sup>369</sup> RESTATEMENT (SECOND) OF CONTRACTS § 133(1)(b) (Tentative Draft No. 3, April 18, 1967), text *supra* note 355.

<sup>370</sup> 44 ALI Proceedings 307-08 (1967).

<sup>371</sup> *Id.* The reporter stated that "[t]he basic spirit of the original Restatement, and of this one, is that it is not the actual intent that counts. It is the manifested intent." Use of the word "intended" was not meant to resurrect concerns with the unspoken mental reservations of the parties. *Id.* at 307.

<sup>372</sup> See 44 ALI Proceedings 308 (1967).

The reporter stated:

In these cases often the problem is one of whether the remedy is one which carries out the intention of the parties or whether the remedy sought is one which is likely to interrupt what the parties were trying to do. We all know that commonly the parties to a contract do not clearly foresee and provide for what happens in the event of a breakdown of the contractual relationship. Their natural focus is on performance, not upon breach.

*Id.* at 308.

<sup>373</sup> *Id.*

<sup>374</sup> *Id.*

<sup>375</sup> See *supra* notes 41-45 and accompanying text.

<sup>376</sup> As finally adopted the creditor class was limited to those involving an actual money debt. RESTATEMENT (SECOND) OF CONTRACTS § 302(1)(a) (1981), text *supra* note 12.

<sup>377</sup> See *supra* notes 355-63 and accompanying text.

eliminate completely the lesser categorization problem.<sup>378</sup> The deficiency in the distinction between intended and incidental beneficiaries is that the parties, or more simply the promisee, may intend a third party to receive a benefit but not intend that party to have standing to enforce the promise.<sup>379</sup> This type of third party, although intended to receive a benefit, would be characterized as an incidental beneficiary not only under the original Section 133 and similar state rules,<sup>380</sup> but also under revised Section 302 of the Restatement (Second).<sup>381</sup>

Two participants suggested that a different term ought to be used to distinguish between those beneficiaries with standing to enforce the promise and those without standing. One participant suggested that "designated beneficiary" ought to be used.<sup>382</sup> This term was dismissed, and properly so, because it offered no real improvement over the term "intended." This conclusion is correct because a beneficiary may be designated to benefit, just as he may be intended to benefit, and yet the parties may not intend that the designated third party have standing to enforce the promise.<sup>383</sup> The second term suggested was "protected beneficiary."<sup>384</sup> Participants acknowledged that this term had been used to make the sought after distinction and the Reporter indicated that it would be considered by the advisory group.<sup>385</sup> The term, however, was not the subject of detailed discussion during the 1967 proceedings and when the discussion of Section 133 was resumed in the 1969 proceedings the Reporter indicated that the search for a term better than "intended beneficiary" had been fruitless.<sup>386</sup> In addition, the Reporter stated, while "intended beneficiary" contained some weaknesses, the advisory group seemed convinced that the term was suitable.<sup>387</sup> No comment from the ALI participants was made in response.<sup>388</sup>

Perhaps one reason why the term "intended beneficiary" seemed acceptable was, as the Reporter pointed out during the 1967 proceedings, the term "fit with a great deal of judicial usage."<sup>389</sup> What may have seemed to the participants to be a reason supporting

<sup>378</sup> See 44 ALI Proceedings 309-10 (1967) (discussion from floor) and 46 ALI Proceedings 331 (1968) (comments of reporter).

<sup>379</sup> See 44 ALI Proceedings 309 (1967) (comment of Judge Ervin Sandor Fulop of New Jersey).

<sup>380</sup> See *supra* notes 102-03 and accompanying text.

<sup>381</sup> See comments of reporter 44 ALI Proceedings 309-10 (1967):

Well, I think I indicated that there was some trouble with the word "intended" . . . . An incidental beneficiary is defined here as one who is not an intended beneficiary . . . . [A third party] may fit . . . the case of intention to give benefit of the promised performance to the incidental beneficiary, and still not fit the other half, where the recognition of a right would be appropriate to carry out the intention of the contracting parties.

*Id.*

<sup>382</sup> 44 ALI Proceedings 309 (1967) (suggestion of Judge Ervin Sandor Fulop of New Jersey).

<sup>383</sup> This term also may have raised yet another problem. See 44 ALI Proceedings 308-09 (1967) (response of the reporter to Judge Fulop's suggestion). Use of the term "designated" would seem to require that the third party somehow be expressly identified as a person intended to benefit and express identification is normally not a requirement. See RESTATEMENT OF CONTRACTS § 139 (1932); RESTATEMENT (SECOND) OF CONTRACTS § 308 (1981); 4 A. CORBIN, CONTRACTS § 781 (1951).

<sup>384</sup> 44 ALI Proceedings 310 (1967). The suggestion was made by Professor Coleman Karesh of South Carolina.

<sup>385</sup> *Id.*

<sup>386</sup> 46 ALI Proceedings 331 (1969).

<sup>387</sup> *Id.*

<sup>388</sup> *Id.* at 332.

<sup>389</sup> 44 ALI Proceedings 310 (1967).

use of the "intended beneficiary" designation, however, may in fact have been a reason against its increased use as a result of its incorporation in the Restatement. The term "intended beneficiary" embodies too much of the difficulties generated by the older standards. The revising drafters almost certainly missed a good opportunity to help resolve the difficulties in this area when they failed to adopt a much different label, such as "protected beneficiary," which would have been more likely to effect a greater change in the approach to third party beneficiary standing because it would represent a greater departure from the older standards. The consequences of this failure to make a more distinct departure have become apparent in light of recent reaction by the courts to the changes incorporated in the revised Restatement as now found in Section 302.<sup>390</sup>

### B. *The Elements of Section 302*

The revised Restatement rule on third party standing, as finally approved,<sup>391</sup> resulted, at worst, in only one change of questionable value: the movement away from the creditor and donee categorization test and its threat of miscategorization problems.<sup>392</sup> Given its most favorable reading, however, the section may be construed as having resolved some significant problems. The early judicial interpretations of Section 302, however, have not been entirely favorable and threaten to rob the revised section of any ameliorating effect.<sup>393</sup> Relevant questions, then, are what exactly are the elements contained in the new formulation of Section 302, and how may it best interact with the rules that preceded it.

The actual text, or black letter portion, of the section is changed in several ways. First, the preamble is changed so that new Section 302 gives proper emphasis to the possibility that the parties may expressly affirm or deny the existence of the third party rights.<sup>394</sup>

<sup>390</sup> See *supra* notes 30-32 and accompanying text and *infra* Appendix.

<sup>391</sup> At the time of the 1969 proceedings the text had been altered in two ways from the 1967 draft, *supra* note 355. First, the creditor-type definition in subsection (1)(a) had been narrowed even further from an actual duty (as opposed to an asserted or supposed duty as in the original Section 133) to simply a monetary obligation, and second, the requirement that recognition be "appropriate to effectuate the intention of the parties" was moved into the preamble so as to apply to (1)(a) creditor-type cases as well as the (1)(b) donee and other types. The draft before the 1969 ALI meeting read:

§ 133. 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 promise manifests an intention to give the beneficiary the benefit of the promised performance. (2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.

RESTATEMENT (SECOND) OF CONTRACTS (Tentative Draft No. 4, April 25, 1968).

The final version printed as Section 302 is identical to the version printed in the RESTATEMENT (SECOND) OF CONTRACTS (Revised and Edited version of Tentative Drafts Nos. 1-7 (1973)). The only additional change from 1969 draft was that subsection (1)(b) was changed to require that "circumstances indicate that the promisee" intend a benefit rather than the earlier versions' requirement that "the promise" manifest an intent to benefit the third party. See *supra* note 12 for text of final version of Section 302.

<sup>392</sup> See *supra* notes 97-118 and accompanying text on the extent of the miscategorization problem.

<sup>393</sup> See *supra* notes 30-32 and accompanying text and *infra* Appendix.

<sup>394</sup> The section is limited in application by its caveat, "[u]nless otherwise agreed by the parties." See *supra* note 12 for text of final version of Section 302.

Although original Section 133 did not explicitly recognize the deference to be accorded express provisions of the parties, no doubt exists that such deference was to be read into the section and that the courts did honor such express provisions.<sup>395</sup>

A second change in Section 302 is the suggestion in the preamble that the basic test for establishing third party standing, in the absence of an express provision, is that recognition of the right to performance be appropriate to effectuate the intention of the parties. This language is relevant to the common law rules in two closely related ways. First, the language should be read not to embody any basic presumption against third party rights.<sup>396</sup> Second, the drafters realistically acknowledged that the third party beneficiary cases are almost exclusively cases involving gaps in the parties' contractual provisions.<sup>397</sup> The approach of the revised statement is not to apply a presumption that disallows third party standing when there is no discoverable actual intent, that is, when a gap exists in the contract, but instead to provide that third party rights should be allowed whenever the grant of standing is consistent with the contractual terms and furthers the goals of the contracting parties.<sup>398</sup> This determination is made by looking at the contract, in light of the circumstances, but does not involve a search for the individual subjective intent of the contracting parties.<sup>399</sup>

The third issue raised by this preamble provision is whether it requires that both parties intend to create third party rights.<sup>400</sup> Indeed, one court has already construed Section 302 to require that both contracting parties manifest individual intent to benefit the third party.<sup>401</sup> While the phrasing of the text leaves itself open for this sort of interpretation,<sup>402</sup> the drafting history refutes the idea that a search for individual subjective intent is at all proper.<sup>403</sup> It is very important for courts to recognize that Section 302 is not meant to impose the restrictive requirement that there be evidence of both parties' individual intent, as some state law rules have required,<sup>404</sup> but rather is meant to focus on the shared intent as reflected in the agreement and surrounding circumstances. In addition to the drafting history, this reading is supported by the reference in Subsection 302(1)(b) to the promisee's intent only in relation to non-creditor cases.<sup>405</sup> This provision suggests that one need look for evidence of an individual party's intent only in that context and not as a general matter. The preamble would require, however, that when the promisee's individual intent is relevant that it be manifest and attributable in some way to the promisor. The promisor must either share, have knowledge of, or have reason to know of the promisee's intent to benefit the third party. This reading would be consistent with the preferred state law on this aspect of the rule.<sup>406</sup>

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<sup>395</sup> See *supra* note 63.

<sup>396</sup> See *supra* notes 41-49 and accompanying text for state law rules, and *supra* notes 372-75 and accompanying text for drafting history of Section 302.

<sup>397</sup> See *supra* notes 372-75 and accompanying text.

<sup>398</sup> See 44 ALI Proceedings 308 (1967).

<sup>399</sup> *Id.*

<sup>400</sup> See *supra* notes 64-67 and accompanying text for state law variations on this aspect of the rule.

<sup>401</sup> See *Williams v. Virgin Island Water & Power Authority*, 672 F.2d 1220, 1227-28 (3d Cir. 1982). The court embarked on a search for evidence of the intent of each party rather than looking to the mutual intent as reflected by the contract under the circumstances.

<sup>402</sup> See *supra* note 12 for text of Section 302.

<sup>403</sup> See *supra* note 371 and accompanying text.

<sup>404</sup> See *supra* note 66.

<sup>405</sup> See *supra* note 12 for text of Section 302.

<sup>406</sup> See *supra* note 73 and accompanying text. Requiring manifest individual intent by both

In addition to the initial requirement that the mutual intent of the parties be advanced by recognition of third party standing, Section 302 requires that one of two alternative requirements be satisfied. The first alternative is that the performance by the promisor satisfy a money debt owed by the promisee to the third party.<sup>407</sup> The second option is that the circumstances indicate that the promisee intends to give the third party the benefit of the promise.<sup>408</sup> These subsections obviously preserve to a large degree the categorization test of the earlier rules. Before addressing that aspect of these subsections, however, it should be noted that both sections contemplate the reading of the contract in light of the surrounding circumstances.<sup>409</sup> The consideration of the circumstances is also consistent with the preamble's phrasing. Section 302 offers no basis for limiting the evidence considered to the express terms of the contract, as some states have done.<sup>410</sup> Those states adopting Section 302 should therefore be prepared to drop such a restrictive requirement.<sup>411</sup>

Returning to the discussion of the categorization aspects, Subsection 302(1)(a) establishes a rather clear standard when combined with the preamble's requirements. If the promisor undertakes to pay a debt of the promisee to a third party, then the third party will have standing to enforce the promise provided that the parties have not expressly agreed otherwise and this right to enforce the promise is consistent with or furthers the mutual intent of the parties as evidenced by the terms of the agreement in light of the surrounding circumstances. This rule comports fully with the common law rules<sup>412</sup> and establishes a clear test for a limited class of transactions — the true creditor beneficiary type.

Subsection 302(1)(b) yields a less definite standard. Read together with the preamble, it establishes that a third party, in a non-creditor status, will have standing if the promisee indicates an intent to give the benefit of the promisor's performance as a gift to the third party, provided that the parties have not expressly agreed otherwise and that this result is consistent with or furthers the mutual intent of the parties as evidenced by the terms of the agreement in light of the surrounding circumstances. Except for its inclusion of some persons previously classified as creditor beneficiaries,<sup>413</sup> this subsection reflects no true change from the donee definition in original Section 133. And the provisions dictate that

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parties is overly restrictive but some knowledge on the part of the promisor probably should be required to prevent unfair surprise. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 302, *illus.* 9 (1981); RESTATEMENT OF CONTRACTS § 133, *illus.* 7 (1932) (suggesting that knowledge attributable to the promisor is important but not requiring his individual subjective intent to benefit).

<sup>407</sup> RESTATEMENT (SECOND) OF CONTRACTS § 302(1)(a) (1981), *supra* note 12.

<sup>408</sup> RESTATEMENT (SECOND) OF CONTRACTS § 302(1)(b) (1981), *supra* note 12.

<sup>409</sup> Section 302(1)(b), *supra* note 12, the broader provision, specifically mentions that the circumstances ought to be considered. Section (1)(a) applies to those situations where a debt is owed by the promisee to the third party. To prevent proof of such a debtor-creditor relationship by extrinsic evidence, and consequently to allow it to go unrecognized unless expressly stated in the terms of the contract, would be illogical. The relevance of the surrounding circumstances in reading Section 302 is consistent with an increased emphasis on the importance of the contracting context as found generally in the Restatement (Second). *See* Braucher, *Interpretation and Legal Effect in the Second Restatement of Contracts*, 81 COLUM. L. REV. 13, 14 (1981).

<sup>410</sup> *See supra* notes 50-62 and accompanying text.

<sup>411</sup> Pennsylvania is such a state, having traditionally required that the intent to benefit be expressed in the contract itself, *see, e.g.*, *Duncan-Lagnese and Associates, Inc. v. Stoney Creek Valley Sewer Authority*, 303 Pa. Super. 236, 239, 449 A.2d 666, 667 (1982), but having recently adopted the RESTATEMENT (SECOND) OF CONTRACTS § 302. *See supra* note 25.

<sup>412</sup> *See supra* notes 126-30 and accompanying text.

<sup>413</sup> *See supra* notes 360-63 and accompanying text.

for this broadest category of third party beneficiaries the test is still the difficult and vague "intent to benefit."

Despite the lack of improvement in the test for non-creditor beneficiaries, the text of Section 302, most favorably viewed as a whole, does reflect a change in basic approach. Original Section 133 required that a party qualify as a donee or creditor beneficiary in order to recover.<sup>414</sup> In contrast, Section 302 requires that a third party qualify as an intended beneficiary to have standing.<sup>415</sup> In both the original and revised formulations, failure to qualify as one of those beneficiaries results in classification as an incidental beneficiary without standing to seek enforcement of a promise from which some benefit might otherwise be derived.<sup>416</sup> The structure of Section 133 suggested, however, that the courts attempt to fit an alleged third party beneficiary into a donee or creditor group based on the characteristics of the parties and the agreement. This approach would ultimately involve a search for the intent of the parties, or at least the promisee, but the focus was on categorization as the decisive test. Section 302 suggests, on the other hand, that the primary inquiry ought to be whether recognition of standing in the third party beneficiary would be appropriate to effect the intent of the parties as indicated by the agreement. In making this determination, the courts should look for creditor status or donative intent on the part of the promisee only as part of the possible evidence that third party rights ought to be allowed. Other indicia may possibly exist. The change from the categorization approach should eliminate the danger that an otherwise qualifying beneficiary might fall into the "gaps" that might exist between or outside of the creditor and donee categories. Those courts adopting Section 302 ought to embrace this change in basic approach.

This threat of miscategorization or falling into "gaps," however, as stated before, was not the major problem in applying the original formulation.<sup>417</sup> Developing and consistently applying standards for measuring intent to benefit was the major problem.<sup>418</sup> The text of Section 302 suggests ascertaining such intent ought to be determinative, but offers little help in identifying relevant criteria. The comments to Section 302 also largely fail in this respect.

The comments in the Restatement (Second) are more developed than those in the original Restatement. This difference is largely attributable to the expectation, held when the original Restatement was drafted, that the ALI would approve a treatise amplifying the otherwise succinct Restatement.<sup>419</sup> At the time the Restatement (Second) was drafted the revisers sought to expand the comments to explain more fully the underlying policies and reasons for the rules and the purposes to be served by them.<sup>420</sup>

All but one of the interpretive comments to the original Section 133 either addressed categorization concerns or identified the fundamental presumptions of the Section.<sup>421</sup>

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<sup>414</sup> See *supra* note 12.

<sup>415</sup> See *supra* note 12.

<sup>416</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 315 (1981) and RESTATEMENT OF CONTRACTS § 147 (1932).

<sup>417</sup> See *supra* notes 97-110 and accompanying text.

<sup>418</sup> See *supra* notes 119-22 and accompanying text.

<sup>419</sup> See RESTATEMENT (SECOND) OF CONTRACTS, Volume I-Foreword at VIII (1981); 44 ALI Proceedings 304-05 (1967) (comments of reporter).

<sup>420</sup> 44 ALI Proceedings 304-05 (1967) (comments of reporter).

<sup>421</sup> Five short comments are appended to original Section 133. Comment *a* explains that a contract may consist of several promises, some perhaps giving rise to third party rights while others might not; comment *b* defines "performance" as the doing or forbearance of acts; comment *c*

The remaining comment merely served to disprove the notion that a third party should necessarily receive direct performance from the promisor in order to receive standing as a beneficiary.<sup>422</sup> The comment offered as an example the possibility that the promisor might contract with the promisee to pay a debt owed by a third party-debtor to a third party-creditor; in this case the third party-debtor is a third party beneficiary with standing even though promised performance does not run directly to him. This caveat, that direct performance to the beneficiary is not necessarily required, is the only clear aid in the comments to Section 133 to finding the requisite intent to benefit.

The illustrations to Section 133,<sup>423</sup> however, do provide more helpful guidance. The illustrations in which standing is found all involve a direct performance by the promisor to the third party.<sup>424</sup> The presence of this common characteristic strongly suggests that while the performance need not always be direct, direct performance to the third party is nonetheless extremely important evidence that there is sufficient intent to benefit to require the recognition of third party beneficiary rights. This conclusion is further substantiated by the often cited illustrations 4<sup>425</sup> and 9<sup>426</sup> which indicate that in construction bond or surety cases the key should be whether the surety is obligated to pay third parties directly or merely to indemnify the promisee against claims of third parties. The use of direct performance as an indicator of sufficient intent is subject to the caveats contained in illustrations 5<sup>427</sup> and 12,<sup>428</sup> which suggest that direct performance, as when a

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explains that the donee class included both "gift" cases and other cases where the promisee manifested an intent to confer a right to the performance; and comment *e* distinguishes property gift cases involving delivery of the goods to the beneficiary from the third party contract cases. RESTATEMENT OF CONTRACTS § 133, comments a, b, c, e (1932).

<sup>422</sup> RESTATEMENT OF CONTRACTS § 133, comment d (1932):

A contract for the benefit of a third person usually provides that performance shall be rendered directly to the beneficiary, but this is not necessarily the case. A promise to discharge an indebtedness of one whom the contract is made to benefit, will provide for payment to the creditor of the beneficiary, not to the beneficiary himself who owes the money.

*Id.*

<sup>423</sup> Thirteen illustrations accompany Section 133. The first four illustrations give examples of donee beneficiaries; illustrations five through ten primarily address creditor type beneficiaries; illustrations eleven and twelve give examples of incidental beneficiaries; and illustration thirteen explains that under Section 133(3) the trustee of a trust rather than the trust beneficiary would have standing as a contract third party beneficiary. RESTATEMENT OF CONTRACTS § 133, illustrations 1-13 (1932).

<sup>424</sup> Only illustration 11 to Section 133, which identifies a true incidental beneficiary, does not involve a direct performance by the promisor to the third party. *See infra* note 430 and accompanying text.

<sup>425</sup> RESTATEMENT OF CONTRACTS § 133, illustration 4 (1932):

D contracts to build a house for A. A obtains from B a bond in which B promises A that all D's creditors for labor and materials who may acquire a lien on the house shall be paid. C is such a creditor of D's. C is a donee beneficiary.

[Also found at RESTATEMENT (SECOND) OF CONTRACTS § 302, illustration 12 (1981).]

<sup>426</sup> RESTATEMENT OF CONTRACTS § 133, illustration 9 (1932):

B promises A for sufficient consideration to pay whatever debts A may incur in a certain undertaking. A incurs in the undertaking debts to C, D and E. If, on a fair interpretation of B's promise, the amount of the debts is to be paid by B to C, D and E, they are creditor beneficiaries; if the money is to be paid to A in order that he may be provided with money to pay C, D and E, they are at most incidental beneficiaries.

[Also found at RESTATEMENT (SECOND) OF CONTRACTS § 302, illustration 3 (1981).]

<sup>427</sup> RESTATEMENT OF CONTRACTS § 133, illustration 5 (1932):

A conveys Blackacre to B in consideration of B's promise to pay \$15,000 as follows:

promise is made to buy an insurance policy or an automobile from a particular dealer, need not create third party beneficiary rights when no creditor status exists, when an absence of intent to benefit the dealer is obvious from the circumstances, and when some other reason for specifying the particular dealer is apparent.<sup>429</sup>

The remaining illustrations to Section 133 otherwise largely serve to make categorization distinctions between the donee and creditor classes with the exception of illustration 11.<sup>430</sup> In this illustration not only is there an absence of direct performance, but also any benefit that the third party would enjoy would be entirely derivative from a more immediate benefit to the promisee. Additionally, and perhaps conclusively, the apparent circumstances are lacking any indication that the contract was entered into to benefit the third party. Any benefit to the third party is truly incidental. This illustration is distinguishable from the hypothetical case in comment *d* which exemplified a case for standing despite the absence of a direct performance.<sup>431</sup> Two important differences found in the comment *d* case are that the main purpose of contracting appears to be to satisfy a debt owed by the third party and that the resulting benefit of having the debt paid is arguably direct.<sup>432</sup> Standing would seem entirely improper in an illustration 11 type case where the performance is not direct, the benefit is entirely derivative, and the circumstances offer no indication that the parties contracted with a purpose of benefitting the third party.

This review of comments and illustrations to Section 133 strongly supports a conclusion that direct performance should normally be the determinative test for determining third party standing but that a direct benefit may also warrant standing, and that in the absence of direct benefit or performance exceptional cases may arise where the purpose

\$5000 to C, A's wife, on whom A wishes to make a settlement, \$5000 to D to whom A is indebted in that amount, and \$5000 to E, a life insurance company, to purchase an annuity payable to A during his life. C is a donee beneficiary; D is a creditor beneficiary; E is an incidental beneficiary.

[Also found at RESTATEMENT (SECOND) OF CONTRACTS § 302, illustration 8 (1981).]

<sup>428</sup> RESTATEMENT OF CONTRACTS § 133, illustration 12 (1932):

B contracts with A to buy A a new Gordon automobile. The Gordon Company is an incidental beneficiary. Though the contract cannot be performed without the payment of money to the Gordon Company, the payment is not intended as a gift nor is the payment a discharge of a real or supposed obligation of the promisee to the beneficiary.

[Also found at RESTATEMENT (SECOND) OF CONTRACTS § 302, illustration 17 (1981).] This illustration was relied upon by the Supreme Court of Alaska in *Ellis v. City of Valdez*, 686 P.2d 700, 704 (Alaska 1984). The court decided that the plaintiff, who owned the airport, could be no more than an incidental beneficiary of a legislative grant agreement between the City of Valdez and the State of Alaska to provide money to city for purchase of the airport where the purpose of legislative grant was to encourage municipal ownership of airport facilities and not to benefit the airport owner.

<sup>429</sup> It is possible, although perhaps not common, that a person might require purchase from a specific dealer in order to confer a benefit upon that dealer. See *R.A. Weaver & Associates, Inc. v. Haas & Haynie Corp.*, 663 F.2d 168, 174-75 (D.C. Cir. 1980) (general and subcontractor reached agreement for use of slate upon premise that it would be purchased from third party, exclusive distributor whose cooperation was required in getting owner approval); cf. *Dravo Corp. v. Robert B. Kerris, Inc.*, 655 F.2d 503, 511 (3d Cir. 1981) (third party standing denied to dealer whose name brand units were expressly required by subcontract where evidence indicated the brand of units was specified merely to require use of lower cost goods).

<sup>430</sup> RESTATEMENT OF CONTRACTS § 133, illustration 11 (1932): "B contracts with A to erect an expensive building on A's land. C's adjoining land would be enhanced in value by the performance of the contract. C is an incidental beneficiary." [Also found at RESTATEMENT (SECOND) OF CONTRACTS § 302, illustration 16 (1981).]

<sup>431</sup> See *supra* note 422 and accompanying text.

<sup>432</sup> *Id.*

of benefitting the third party is so obvious that standing should be allowed.<sup>433</sup> This conclusion is largely consistent with the state law rules actually applied.<sup>434</sup>

The comments and illustrations to the new Section 302 further substantiate the conclusions drawn from the comments and illustrations to the original Section 133. Comment *a*, much like comment *d* to Section 133,<sup>435</sup> indicates that neither direct performance nor direct benefit is an absolute requirement for third party standing.<sup>436</sup> This suggestion, again, should be read in light of the Section 302 illustrations. These illustrations include all of those from the original Section 133 plus several consistent additions and all involve findings of intended beneficiary status only where either the performance or the benefit could be considered direct.<sup>437</sup>

Comment *b* to Section 302 also substantiates a conclusion that was to be drawn from the original Section 133 rule. When a true creditor or similar status is held by the putative third party beneficiary, a strong presumption should exist that third party standing was intended because such standing is appropriate to carry out the intent of the parties.<sup>438</sup> Unfortunately, comment *c*<sup>439</sup> does not establish any clear presumptions that should apply

<sup>433</sup> The drafters of the Restatement (Second) could hardly be unfamiliar with the thought that direct performance should be an important factor since the decisions of the courts very often focused on that element and one writer had proposed, in a widely cited comment on the third party beneficiary rules, that direct performance should always be the determinative factor. See Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406, 425-28 (1957). The drafters would undoubtedly have perceived the undue restrictiveness of the later proposal but perhaps in attempting to avoid such a restrictive rule adopted an equally faulty approach, the modified categorization test. This article suggests, in part, that a better approach would have been to build upon the direct performance test rather than to attempt to establish an effective categorization test.

<sup>434</sup> See *supra* notes 123-331 and accompanying text.

<sup>435</sup> See *supra* note 422.

<sup>436</sup> RESTATEMENT (SECOND) OF CONTRACTS § 302, comment *a* (1981) reads in part: Section 2 [of the Restatement (Second)] defines "promisee" as the person to whom a promise is addressed, and "beneficiary" as a person other than the promisee who will be benefited by performance of the promise. . . . Either promisee or beneficiary may but need not be connected with the transaction in other ways: neither promisee nor beneficiary is necessarily the person to whom performance is to be rendered, the person who will receive economic benefit, or the person who furnished the consideration.

*Id.*

<sup>437</sup> Section 302 has twenty illustrations. Thirteen of the illustrations are directly based on the thirteen illustrations to Section 133 of the original Restatement of Contracts with minor modifications to reflect the change from the "creditor/donee" labels to the "intended" beneficiary term for those with standing. Four of the new illustrations (numbers 4, 6, 10, 14) involve what may easily be called direct benefit or performance as a basis for finding third party beneficiary rights. New illustration 15 incorporates third party warranty rights as required under Uniform Commercial Code § 2-318. The other new illustrations, numbers 18 and 19, portray a lack of third party standing in hypothetical situations in which the performance is not direct and the benefit is clearly derivative from a more immediate benefit to the promisee. RESTATEMENT (SECOND) OF CONTRACTS § 302, illustrations 1-20 (1981).

<sup>438</sup> RESTATEMENT (SECOND) OF CONTRACTS § 302, comment *b* (1981) indicates that when the contract contains a promise to pay the promisee's debt, "a direct action by the [creditor] beneficiary against the promisor is normally appropriate to carry out the intention of promisor and promisee, even though no intention is manifested to give the beneficiary the benefit of the promised performance." The last part of this statement is undoubtedly intended to mean that standing is appropriate even without an express statement by the parties that such was intended.

<sup>439</sup> RESTATEMENT (SECOND) OF CONTRACTS § 302, comment *c* (1981) reads:

*Gift promise.* Where the promised performance is not paid for by the recipient, discharges no right that he has against anyone, and is apparently designed to benefit him,

in the broader and more difficult non-creditor circumstances.<sup>440</sup> One is left to the conclusions which may be drawn from the text and illustrations in establishing an intent standard for non-creditor beneficiaries, that is, that direct performance or benefit to the third party are the most reliable indicia of third party standing in non-creditor cases.

An exception is that in comment *d* the revising drafters make a significant but highly questionable departure from the popular construction of the original Restatement of Contracts Section 133 by offering a "reliance" standard for measuring intent.<sup>441</sup> In this comment, the drafters suggest that if the circumstances include either a promise to pay a debt owed by the promisee to a third party or a manifestation of intent to give the third party the benefit of a promised performance, then the third party is an intended beneficiary if he would be reasonable in relying on the promise.<sup>442</sup>

The suggestion that reasonable reliance should be a measure for determining third party standing is objectionable for two reasons.<sup>443</sup> First, courts are not likely to be able to apply a reasonable reliance standard any more easily than the more traditional intent standard. Instead, the reasonable reliance standard, at best, appears to involve an evaluation of essentially the same contract terms and surrounding circumstances as in the traditional intent test. This addition of a differently labeled theory for determining third party standing is sure to engender more confusion in this area.<sup>444</sup> A second basis for

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the promise is often referred to as a "gift promise." The beneficiary of such a promise is often referred to as a "donee beneficiary;" he is an intended beneficiary under Subsection (1)(b). The contract need not provide that performance is to be rendered directly to the beneficiary: a gift may be made to the beneficiary, for example, by payment of his debt. Nor is any contract or communication with the beneficiary essential.

<sup>440</sup> See *supra* notes 119-22, 412-13 and accompanying text.

<sup>441</sup> RESTATEMENT (SECOND) OF CONTRACTS § 302, comment *d* (1981) reads in part: "Either a promise to pay the promisee's debt to a beneficiary or a gift promise involves a manifestation of intention by the promisee and promisor sufficient, in a contractual setting, to make reliance by the beneficiary both reasonable and probable. . . . In such cases, if the beneficiary would be reasonable in relying on the promise as manifesting an intention to confer a right on him, he is an intended beneficiary."

<sup>442</sup> *Id.*

<sup>443</sup> Although the Reporter's Note to Section 302, comment *d*, suggests some cases in which the reliance theory may have been deemed helpful, other courts have appeared to reject reliance arguments. See, *White v. Alaska Ins. Guaranty Ass'n.*, 592 P.2d 367, 369 (Alaska 1979) ("A third party cannot make himself a creditor beneficiary merely by acting in reliance upon a contract."); *Brown v. Summerlin*, 272 Ark. 298, 300, 614 S.W.2d 227, 229 (1981) ("Nothing at all was said between the parties to indicate that appellant had a right to rely on that survey . . . no doubt, he expected to benefit from it but mere expectation is insufficient to give rise to that of an intended beneficiary."); *Garcia v. Truck Ins. Exchange*, 204 Cal. Rptr. 435, 441 n.5, 682 P.2d 1100, 1105 n.5, 36 Cal. 3d 426 (1984) (putative beneficiary cannot create rights by acting in reliance on contract) (citing 4 A. CORBIN, CONTRACTS § 779B (1951)).

<sup>444</sup> The confusion, indeed, has already begun. In *Pennsylvania Liquor Control Board v. Rapisanta, Inc.*, 472 Pa. 36, 45, 371 A.2d 178, 182 (1976), the Pennsylvania Supreme Court interpreted Section 302 [then Section 133 of Rev. ed. Tentative Drafts I-7, 1973] and comment *d* to require that "a third party is an intended beneficiary only if he can reasonably rely on the contract as manifesting an intent to confer a right on him." When the same court later adopted Section 302 as establishing a standard for third party beneficiary rights, see *supra* note 25, the majority opinion did not mention the reliance test even though the intermediate appellate court had considered reasonable reliance to be required. See *Guy v. Liederbach*, 279 Pa. Super. 543, 552, 421 A.2d 333, 337 (1980), *aff'd in part and rev'd in part*, 501 Pa. 47, 459 A.2d 744 (1983). The dissent of Chief Justice Roberts to the Supreme Court decision, however, emphasized that the case then under consideration (suit by an intended legatee against an attorney who improperly drafted a will) was not one in which the third party beneficiary could have had reasonable reliance. *Guy v. Liederbach*, 501 Pa. 47, 65, 459 A.2d 744, 754 (1983) (Roberts, C.J., dissenting).

objecting to the reliance standard is that mere reliance by a third party should not be used to bind a promisor to full performance. At most, the promisor should be liable for the usual reliance measure of relief if he has contracted in such a manner or otherwise given the third party a basis for reasonable reliance on a contract that otherwise does not warrant third party beneficiary standing.<sup>445</sup>

Returning to the first point, a reliance standard would involve the very same considerations as the intent test. The reliance test as structured by Restatement (Second) of Contracts Section 90 suggests that the important factors are the reasonable foreseeability by the promisor that the third person might act or forbear from acting based on the promise and actual, justifiable reliance by the third person.<sup>446</sup> Both aspects of this test depend on the degree to which the terms and circumstances manifest an intent to confer a right on the third party. The reliance test, therefore, like the Section 302 standard, revolves on objective factors<sup>447</sup> and arguing that reliance is justifiable would be difficult when the terms and circumstances fail to give some basis for concluding that recognition of third party rights is consistent with the goals of the contracting parties.

The alternative to reading the reliance test as equivalent to the intent test is to suggest that reliance of a less objective and more subjective nature should be enough to warrant third party rights.<sup>448</sup> The additional obligation on the promisor by virtue of third party standing is sufficiently substantial that mere subjective reliance, unsupported by an objective basis, should not be sufficient for standing under the third party beneficiary doctrine.<sup>449</sup> This conclusion also relates to the second basis for rejecting the reliance approach.

In the courts of Nevada the reliance test, phrased as foreseeable rather than reasonable reliance, has already appeared in a confusing way. In its decision in *Lipshie v. Tracy Investment Co.*, the Supreme Court stated that for third party beneficiary rights to exist "ultimately it must be shown that the third party's reliance thereon is foreseeable." 93 Nev. 370, 379, 566 P.2d 819, 824-25 (1977). The Supreme Court cited its earlier decision in *Lear v. Bishop*, 86 Nev. 709, 476 P.2d 18 (Nev. 1970) in support, but a close reading of the *Lear v. Bishop* case indicates that reliance was not suggested as an alternative third party beneficiary test but as an extension of the promissory estoppel doctrine to third parties. *Id.* at 714, 476 P.2d at 22. In contrast, the *Lipshie* opinion seems to construe foreseeable reliance as an essential part of the third party beneficiary test.

<sup>445</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 90 and comments b and c (1981).

<sup>446</sup> *Id.* See also E. FARNSWORTH, CONTRACTS § 2.19 (1982).

<sup>447</sup> See E. FARNSWORTH, CONTRACTS § 2.19 (1982).

<sup>448</sup> RESTATEMENT (SECOND) OF CONTRACTS § 90, comment c seems to acknowledge the possibility of justifiable reliance in some instances when the third party beneficiary intent standard is not met. Illustrations 5-7 to § 90 offer examples. Illustration 6, for example, reads:

A executes and delivers a promissory note to B, a bank, to give B a false appearance of assets, deceive the banking authorities, and enable the bank to continue to operate. After several years B fails and is taken over by C, a representative of B's creditors. A's note is enforceable by C.

It is difficult to imagine that C in this hypothetical situation could qualify as a third party beneficiary under Section 302, Section 133, or other traditional standards.

For a case involving facts that may have given rise to reasonable reliance but not third party beneficiary rights, see *Braten v. Banker's Trust Co.*, 60 N.Y.2d 155, 456 N.E.2d 802, 468 N.Y.S.2d 861 (1983). The defendant allegedly made a promise to the borrower-corporation in the presence of the borrower's suppliers that the defendant would continue to extend credit. No promise was made that the suppliers would be paid, but they may have been reasonable in continuing credit to the corporation in reliance on the representation of the bank. This possibility, however, is not discussed in the opinion.

<sup>449</sup> See *Beverly v. Macy*, 702 F.2d 931, 941-42 (11th Cir. 1983) (citing RESTATEMENT (SECOND) OF

The second objection to the reliance test is that the language in comment *d* to Section 302 seems to suggest that the promise ought to be fully enforceable against the promisor if justifiable reliance can be shown. This suggestion is inconsistent with the general tenor of Section 90 that reliance interests ought to be redressed only as necessary to prevent injustice.<sup>450</sup> Section 302 fails to contain any cross-reference to Section 90 and its limits on liability.<sup>451</sup> The cases to date which have considered reliance theories for determining third party standing have not acknowledged any such limit on liability.<sup>452</sup>

If one assumes that reliance might be justifiable in circumstances where the parties have failed to satisfy the traditional intent standard,<sup>453</sup> to give the reliance interest of the third person greater protection than the limited remedy available to the promisee under Section 90 would be anomalous.<sup>454</sup> A third party by the very nature of his relationship to the transaction should receive no more than the standard, limited reliance protection.<sup>455</sup> This caveat notwithstanding, if the contract and the surrounding circumstances provide manifest evidence sufficient to offer a clear basis for reliance, then the third party will very likely achieve normal third party rights under Section 302 and its third party beneficiary test. If the justifiable reliance is based on a different or lesser standard,<sup>456</sup> then the relief afforded should not be full enforcement of the promise but only so much enforcement as necessary to prevent injustice. This protection is better governed by the Section 90 formulation on reasonable reliance than the Section 302 standards.

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CONTRACTS § 302, comment d). The Court considered reliance as a factor in determining third party standing but clearly indicated that reliance alone would not be enough.

Other federal cases considering the reliance test fail to indicate how this measure differs from the intent standard. The cases deny or find reasonable reliance on the same grounds that intent to benefit would be deemed present or lacking. *See Pstragowski v. Metropolitan Life Ins. Co.*, 553 F.2d 1, 5 (1st Cir. 1977) (wife could not reasonably rely on husband's employment contract for benefits since her benefit depended entirely on his continued employment and the continuation of their marriage, both of which were necessarily uncertain); *Commercial Ins. Co. v. Pacific-Peru Construction Co.*, 558 F.2d 948, 953-54 (9th Cir. 1977) (reasonable reliance by reinsurer found upon express term of bond agreement in which contractor promised to indemnify surety and any reinsurer); *Taylor Woodrow Blitman Construction Corp. v. Southfield Gardens Co.*, 534 F. Supp. 340, 343-44 (D. Mass. 1982) (reliance on the part of the contractor was not reasonable because the relevant promises were expressly for the benefit of laborers and materialmen, not the contractor).

<sup>450</sup> RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1981) provides:

A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

The remedy granted for breach may be limited as justice requires.

RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1981).

<sup>451</sup> At least one other writer has observed the possible inconsistency between Section 90 and Section 302 regarding reliance by a third party. *See Knapp, Reliance in the Revised Restatement: The Proliferation of Promissory Estoppel*, 81 COLUM. L. REV. 52, 61 n.59 (1981). *See also Metzger & Phillips, The Emergence of Promissory Estoppel as an Independent Theory of Recovery*, 35 RUTGERS L. REV. 472, 543-44 (1983) (interpreting Section 90 provisions as not allowing for non-intended beneficiary, third party reliance).

<sup>452</sup> *See cases cited supra* notes 444 and 449.

<sup>453</sup> *See supra* notes 446-49 and accompanying text.

<sup>454</sup> *See* RESTATEMENT (SECOND) OF CONTRACTS § 90(1) and comment d (1981).

<sup>455</sup> Some recent writings have questioned the relegation of the reliance interest to a lesser position in the remedial hierarchy and have suggested that expectancy relief should be available, and perhaps is presently available as a practical matter, in reliance cases. *See, e.g., Feinman, Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 685-88 (1984).

<sup>456</sup> *See supra* note 448 and accompanying text.

## IV. SUMMARY

A. *The Failings of Section 302*

In summary, the new third party standing test as stated in Section 302,<sup>457</sup> and as amplified by the comments and illustrations to the section, suffers from two clear failings. The test does offer, however, a vehicle for taking the best from the state law rules as they have been observed to be stated<sup>458</sup> and applied in the foregoing discussion.<sup>459</sup> The first failing of Section 302 is the move from the creditor-donee-incidental categorization test, with its threat of "gap" cases,<sup>460</sup> to the new intended-incidental categories which still remain partly inappropriate and misleading<sup>461</sup> and are so closely aligned with the older categories that many courts have not perceived any change.<sup>462</sup> The second failing is the introduction of reasonable reliance as a test for establishing third party beneficiary rights. When used properly, the reasonable reliance test would involve the same considerations the traditional intent standard involves. The introduction of this "different" name for the standard, however, creates the real risk of additional confusion as courts wrestle not only with the "intent to benefit" test but with the "reasonable reliance" rubric as well.<sup>463</sup> Indeed the decisions of the courts have already reflected the potential for confusion.<sup>464</sup> Moreover, if third party reliance should serve as a basis for recovery, the principles established by Section 90 and similar rules, including the principle permitting recovery only to the extent necessary to avoid injustice, should govern.<sup>465</sup>

B. *The Optimal Construction of Section 302*

On the positive side, Section 302 lends itself to a construction consistent with the best of the state law rules. The section, as phrased and as understood in light of its drafting history, carries no presumption against third party standing.<sup>466</sup> Rather, the section is designed to render decisions consistent with the parties' manifest intent when such intent can be found. But in the event of a gap in the parties' agreement, where third party rights were not contemplated, Section 302 endorses a neutral framework for deciding whether recognition of third party rights would be consistent with the manifest intent and goals of the contracting parties.<sup>467</sup>

The revised section expressly and implicitly requires that courts look to surrounding circumstances in determining whether standing should be had.<sup>468</sup> This section is thus at odds with those jurisdictions requiring that the indicia of intent be totally or partially expressed in the contract.<sup>469</sup> Section 302 requires that third party beneficiary standing be consistent with the mutual intent of the parties as manifested by the agreement, but does

<sup>457</sup> See *supra* note 12.

<sup>458</sup> See *supra* notes 41-122 and accompanying text.

<sup>459</sup> See *supra* notes 126-331 and accompanying text.

<sup>460</sup> See *supra* notes 97-118 and accompanying text.

<sup>461</sup> See *supra* notes 378-88 and accompanying text.

<sup>462</sup> See *infra* Appendix.

<sup>463</sup> See *supra* notes 443-49 and accompanying text.

<sup>464</sup> See *supra* note 444.

<sup>465</sup> See *supra* notes 448-50 and accompanying text.

<sup>466</sup> See *supra* notes 396-98 and accompanying text.

<sup>467</sup> *Id.*

<sup>468</sup> See *supra* notes 409-11 and accompanying text.

<sup>469</sup> See *supra* notes 50-59 and accompanying text.

not require that evidence of both parties' individual, subjective intent be presented.<sup>470</sup> Thus, the section is pliable in this respect and should be read to require the less restrictive showing that the promisor have reason to know that third party standing might be warranted by the contractual promises.<sup>471</sup>

The text of the section establishes a clear intent standard only for the true creditor type cases<sup>472</sup> but analysis of the illustrations establishes standards for the non-creditor cases: direct performance to the beneficiary should normally be sufficient to establish third party standing;<sup>473</sup> where a benefit, rather than the performance, can be considered direct to the beneficiary or is an obvious purpose for which the contract was made — as in the case where a debt is paid on behalf of the beneficiary — then standing should also be proper;<sup>474</sup> but where neither the performance nor the benefit is direct, and the benefit received is not an apparent purpose for contracting and is derived only from a distinctly more immediate benefit to the promisee or some other party, then third party standing is inappropriate.<sup>475</sup> These rules are subject to the general limits that express provisions or patently clear circumstances may vary the outcome in some cases. In applying the Section 302 intent standards, the existence of creditor or naturally donative relationships may be helpful but the approach of the courts should not be to attempt to fit putative beneficiaries into one of the categories with the absence of a "fit" resulting in classification as an incidental beneficiary without standing.<sup>476</sup>

### C. Applying Section 302 to the Common Cases

#### 1. Creditor Beneficiary Cases

Section 302, as construed above, will produce results consistent with the common law rules in the case of true creditor beneficiaries.<sup>477</sup> Subsection (1)(a) would grant standing unless the parties otherwise expressly agreed that no third party rights would arise or the circumstances were such that the court was convinced that such recognition was not proper to effectuate the intent of the parties. In practically every case where a promisor agreed to pay the debt or fulfill the clear duty of the promisee to a third party, however, that third party would have standing.<sup>478</sup>

#### 2. Gift Cases

The true gift cases<sup>479</sup> are also easily decided under Section 302 as amplified by the illustrations. Where the promisor promises to give a direct performance and benefit to the third party, and the circumstances are such that donative intent is expressed or easily inferred, for example in family relationships, then third party standing should be had.<sup>480</sup>

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<sup>470</sup> See *supra* notes 400-06 and accompanying text.

<sup>471</sup> *Id.*

<sup>472</sup> See *supra* text accompanying note 412.

<sup>473</sup> See *supra* notes 424-29, 437 and accompanying text.

<sup>474</sup> See *supra* note 422 and accompanying text.

<sup>475</sup> See *supra* notes 430-32 and accompanying text.

<sup>476</sup> See *supra* notes 414-16 and accompanying text.

<sup>477</sup> See *supra* notes 126-30 and accompanying text.

<sup>478</sup> See *supra* note 438 and accompanying text.

<sup>479</sup> See *supra* notes 140-52 and accompanying text.

<sup>480</sup> See *supra* notes 436-37 and accompanying text.

### 3. Intended Legatees on Contracts to Draft Wills

The cases involving attempts to gain third party standing by intended legatees on contracts to draft wills present the same difficulties under Section 302 as they have under the state law rules.<sup>481</sup> In these cases the performance of the attorney drafting the will is given directly to the testator-promisee and not to the intended legatees. The difficult question is whether the benefit to the intended legatees is direct in the sense of being immediate or is only derived from the more direct benefit to the testator.

On this question courts could split even when applying the best construction of Section 302, but the author would side against third party standing because the benefit is probably too tenuous to be considered sufficiently direct and it is also difficult to conclude that standing is consistent with the mutual contracting purposes of the parties. The testator has the unrestricted freedom to revoke the will at any time before death. Contrasting the intended beneficiary of an irrevocable trust with the legatee of a will may help illustrate the point. An attorney drafting an irrevocable trust should be keenly aware of the immediate benefit to the trust beneficiary and the effects of an error in drafting. This degree of immediacy and certainty in the benefit in that type of trust case is absent in the cases of contracts to draft wills. This lack of immediate and certain benefit supports denying relief under a contract third party beneficiary theory, although relief may be available through some other theory or cause of action.

### 4. Employees, Shareholders and Partners

Employees, shareholders and partners would generally fare no better under the improved Section 302 than they would under the state law rules.<sup>482</sup> These putative third party beneficiaries would normally be denied standing on the contracts of their related business entities, absent an express provision for their benefit, because the performance is not direct and the benefit is derivative of a more immediate benefit to the business entity.

The possible exception to this outcome would be in employee cases where the employer contracts with a third party to provide some direct service to the employee, such as security guard services on business premises.<sup>483</sup> In this case, the argument can be made that the benefit is direct to the employee because he is saved from the harm threatened by robbery or other violence. The benefit to the employer is at least partly derivative from the benefit to the employee because the employer is relieved of the expense and difficulty related to employee injury. Consequently, where the benefit or performance to the employee can be characterized as direct, third party rights should be presumed unless rebutted by express provisions to the contrary or circumstances clearly denying grounds for third party standing.

### 5. Government Contract Cases

In applying Section 302 to cases involving the government,<sup>484</sup> distinguishing between the true public service contracts and other contracts to which government entities are parties is important. In the public service cases the higher requirements for showing intent to qualify as a third party beneficiary would be properly applied.<sup>485</sup> The normal

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<sup>481</sup> See *supra* notes 153-63 and accompanying text.

<sup>482</sup> See *supra* notes 164-77 and accompanying text.

<sup>483</sup> See *supra* notes 168-72 and accompanying text.

<sup>484</sup> See *supra* notes 178-92 and accompanying text.

<sup>485</sup> See *supra* notes 178-89 and accompanying text.

rules would control and would require a search for either direct performance or benefit to the third parties when applying Section 302 to the other government contracts. In the government mortgage-insured housing cases<sup>486</sup> this test should result in a finding of third party standing for tenants who benefit from limits on rent, provision of subsidies for rent, or maintenance and safety requirements under regulatory agreements between the landlord-owners and the federal government. This result should obtain because this type of contract is not a public service contract and the pecuniary and health benefit to the tenants are immediate and direct. The tenants would be required to establish a breach, but should have standing under the regulatory agreements.

#### 6. Construction Contract Cases

The decisive factor in most of the construction contract cases<sup>487</sup> would be the nature of the promised performance. In those cases involving surety arrangements<sup>488</sup> or promises to repair damages<sup>489</sup> caused during construction, the key under Section 302, as under the existing state law rules,<sup>490</sup> will be whether the promisor promised to pay the putative beneficiary directly or merely promised to indemnify the promisee. In these cases if the performance is not direct then the benefit will be indirect as well and the injured third party will recover only through the promisee.

The construction cases involving multi-prime contractors<sup>491</sup> with separate contracts with the owner probably ought to give rise to third party rights only if the proper performance of one contractor is a prerequisite to the ability of the other contractors to perform and the contracting circumstances indicate an arrangement by which the contractor assumes an obligation that otherwise would be owed by the owner. Third party rights would not arise if the owner retained his obligation to the contractors to provide a proper work site. Thus, when one contractor must provide some performance or service, for example controlling excess water, that is of direct and immediate benefit to the others and fulfills a duty that would otherwise be incumbent on the owner, then third party rights ought to exist unless the express agreements or manifest circumstances reflect a different intent on the part of the contracting parties.

A very difficult question arises in the last category of construction cases in which owners seek standing against non-privity subcontractors.<sup>492</sup> The general contractor in these cases is usually something more than a mere conduit. If the subcontractor renders faulty performance, the general contractor will have an obligation to the owner to correct the problems before delivery of the completed building or project. If the breach causes additional costs in terms of time or money, the general contractor initially will feel the effects. The overriding obligation of the general contractor to tender a completed performance prevents a clear conclusion that the owner is directly affected. Therefore, if standing should be found, it should not be because of the directness of the performance or the owners' benefit but because it is deemed consistent with the goals of the contracting parties. It is quite arguable that suit by the owner for breach, as opposed to suit by the general contractor, would normally be consistent with the purposes and goals of the

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<sup>486</sup> See *supra* notes 209-41 and accompanying text.

<sup>487</sup> See *supra* notes 242-94 and accompanying text.

<sup>488</sup> See *supra* notes 257-66 and accompanying text.

<sup>489</sup> See *supra* notes 282-94 and accompanying text.

<sup>490</sup> See *supra* notes 257-60, 282-94 and accompanying text.

<sup>491</sup> See *supra* notes 267-81 and accompanying text.

<sup>492</sup> See *supra* notes 242-56 and accompanying text.

contracting parties since the subcontractor will always be aware that the owner ultimately is the party with the greatest interest in his proper performance. This difficult class of cases is probably one upon which courts will continue to be divided.

### 7. Real Property Transactions

In the real property transactions, Section 302 provides a solid answer for those cases involving an appraisal, survey, inspection, or other services related to a contract to purchase a home.<sup>493</sup> In these cases both the home purchaser and either the seller or lender receive a direct benefit from having a correct appraisal or similar service. The third party purchaser's benefit from proper performance by the promisor-appraiser, surveyor or inspector is no less direct than the benefit to the promisee-lender or seller. Third party standing ought to be disallowed only when the express terms or the circumstances deny standing, such as when the purpose of the appraisal, survey or inspection is not made known to the promisor so that he is not chargeable with reason to know that there is a third party purchaser who might benefit.

A last difficult question, even for the improved Section 302, is the case of the home purchaser who wishes to sue the remote builder.<sup>494</sup> The benefit to the ultimate purchaser of having a well-built home is substantial, but it is difficult to describe the builder's performance as being direct. Nor is the benefit direct at the time of performance, although it later becomes immediate in the sense that a quality home will be of most immediate benefit to those who live in it. Acknowledging the absence of a clearly direct benefit or performance and therefore resorting to the general principles of Section 302, it is probably fair to say that when the builder knows the home will be resold, recognition of third party standing in the home owner is consistent with the purposes and goals of the contracting parties. If the home were occupied by the developer then he would have a cause of action if the building contract was breached. Resale of the home should probably not be deemed to bar suit by the ultimate purchaser, even though the performance and the benefit are not directly given to purchaser. This case, however, presents another close question upon which courts are likely to disagree even when applying the most useful construction of Section 302.

### CONCLUSION

The courts have traditionally decided third party beneficiary standing cases by using the rather vague test of "intent to benefit" in conjunction with collateral rules developed in attempts to fortify the intent standard. While Section 133 of the original Restatement of Contracts did not serve as a way out of those confused and difficult intent tests, Section 302 of the Restatement (Second) of Contracts has the potential for serving such a function.

The objective of this article is to offer an interpretation of Section 302 that highlights the helpful provisions and warns against the potential pitfalls. Section 302 could have been written to go further in making a departure from the flaws of the traditional rules, but when best construed the section can be used to establish clear, useful standards for determining third party beneficiary standing. The challenge for those states adopting Section 302 is to perfect its rule by uncovering those clear, useful standards which lie

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<sup>493</sup> See *supra* notes 318-31 and accompanying text.

<sup>494</sup> See *supra* notes 302-17 and accompanying text.

within the text and supporting materials of the section. The resulting construction of Section 302, when studiously applied to third party beneficiary cases, should yield standards that are consistent with the best parts of existing state law rules and that provide effective guidance in those cases where the existing state law rules have been inadequate.

#### APPENDIX

Listed below are decisions of courts in which Section 302 has been adopted, used or commented on in a manner which reflects whether the section has been deemed comparable, in whole or in part, with prior law. The section has been cited in other cases without any interpretative reading.

*California* — The court in *Gilbert Financial Corp. v. Steelform Contracting Co.*, 82 Cal. App. 3d 65, 70-71, 145 Cal. Rptr. 448, 451 (1978), read Section 302 as constituting an improvement over the categorization test of Section 133, but the court in *Walters v. Marler*, 83 Cal. App. 3d 1, 31-32, 147 Cal. Rptr. 655, 674-75 (1978) viewed the change as being entirely semantic. Subsequently, the court in *Allan v. Bekins Archival Service, Inc.*, 154 Cal. Rptr. 458, 463 (Cal. Ct. App. 1979), observed that the creditor-donee distinction was beginning to disappear in California. There appears to be, however, no more recent cases supporting this conclusion.

*Delaware* — The federal court in *American Financial Corp. v. Computer Services Corp.*, 558 F. Supp. 1182, 1185 (D. Del. 1983) (applying Delaware law) read Section 302 to require that evidence of both parties' intent to create third party beneficiary rights be present.

*Illinois* — The Supreme Court of Illinois, in both *Altevogt v. Brinkoetter*, 85 Ill. 2d 44, 54-56, 421 N.E.2d 182, 187 (1981) and *Resnik v. Curtis & Davis Architects & Planners, Inc.*, 78 Ill. 2d 381, 384-85, 400 N.E.2d 918, 919-20 (1980), implicitly has read Section 302 to be consistent with its traditional third party beneficiary rule found in *Carson, Pirie Scott & Co. v. Parrett*, 346 Ill. 252, 259, 178 N.E. 498, 501 (1931).

*Iowa* — The Supreme Court seemed to question severely, if not reject, the elimination of the categorization standard in Section 302 in its opinion in *Khabbaz v. Swartz*, 319 N.W.2d 279, 284-85 (Iowa 1982). The Court of Appeals has followed *Khabbaz v. Swartz* and continued to apply the Section 133 categorization test. *Bain v. Gillispie*, 357 N.W.2d 47, 50 (Iowa Ct. App. 1984).

*Kansas* — The Kansas courts have cited Section 302 while applying the Section 133 categorization test, indicating a failure to appreciate a significant difference between the two versions. See *Martin v. Edwards*, 219 Kan. 466, 472-73, 548 P.2d 779, 785 (1976); *Lewis v. Globe Construction Co., Inc.*, 6 Kan. App. 2d 478, 486, 630 P.2d 179, 185 (1981).

*Maryland* — The Court of Special Appeals viewed Section 302 as containing a "liberalized" standard. *Weems v. Nanticoke Homes Inc.*, 37 Md. App. 544, 556-57, 378 A.2d 190, 197 (1977). But in *White v. General Motors Corp.*, 541 F. Supp. 190, 194 (D. Md. 1982) (applying Maryland law) the court perceived no change from Section 133 other than the dropping of the creditor and donee labels.

*Massachusetts* — Section 302 has been adopted as reflective of the state's law, *Rae v. Air-Speed, Inc.*, 386 Mass. 187, 194, 435 N.E.2d 628, 632 (1982); *Choate Hall & Stewart v. SCA Servs. Inc.*, 378 Mass. 535, 545-46, 392 N.E.2d 1045, 1051 (1979). The cases offer no general interpretation of the section but the court in *Rae* used the reasonable reliance measure of comment *d* to Section 302 in reaching its decision.

*Minnesota* — The Supreme Court of Minnesota replaced its former categorization test by adopting the Section 302 rule in *Cretex Companies v. Construction Leaders, Inc.*, 342

N.W.2d 135, 139 (Minn. 1984). In doing so, the court also sought to dispel the reading of its prior decisions that would limit third party rights to cases where the promisee owed a duty to the third party.

*New Jersey* — The Supreme Court of New Jersey has favorably cited Section 302 in indicating that the contractual intent rather than the categorization test should be determinative in third party beneficiary decisions. *Broadway Maintenance Corp. v. Rutgers*, 90 N.J. 253, 260, 447 A.2d 906, 909 (1982).

*North Carolina* — The courts of North Carolina have interpreted Section 302 as working no change from Section 133. *Reidy v. Macauley*, 57 N.C. App. 184, 186, 290 S.E.2d 746, 747 (1982); *Alva v. Cloninger*, 51 N.C. App. 602, 608-09, 277 S.E.2d 535, 539 (1981). In *Snyder v. Freeman*, 300 N.C. 204, 211, 266 S.E.2d 593, 604 (1980), the Supreme Court fully applied Section 302 without recognizing that the section was different from Section 133 which the court formally adopted in *Vogel v. Reed Supply Co.*, 277 N.C. 119, 127-28, 177 S.E.2d 273, 278 (1970).

*North Dakota* — In *First Federal S & L Ass'n v. Compass Investments*, 342 N.W.2d 214, 219 (N.D. 1983), Section 302 is cited in conjunction with Section 133 and prior state law without noting possible differences in the standards.

*Pennsylvania* — The Supreme Court adopted Section 302 in its opinion in *Guy v. Liederbach*, 501 Pa. 47, 51, 459 A.2d 744, 746 (1983), not in overruling but merely supplementing its prior law. The prior prevailing law was stated in *Spires v. Hanover Fire Ins. Co.*, 364 Pa. 52, 56-57, 70 A.2d 828, 830 (1950), and had required that both parties express an intent to benefit the third party in the contract itself before third party rights would arise. The court offered no clear guidance for resolving the inconsistencies between the *Spires* rule and Section 302.

The court also failed to indicate whether reasonable reliance was essential for third party rights under Section 302 as it had suggested in its earlier decision in *Pennsylvania Liquor Control Board v. Rapistan, Inc.*, 472 Pa. 36, 44, 371 A.2d 178, 181-82 (1976), and as that decision had been interpreted by other courts in *Holt Hauling & Warehousing Systems, Inc. v. Rapistan, Inc.*, 448 F. Supp. 991, 994 (E.D. Pa. 1978) and *Guy v. Liederbach*, 279 Pa. Super. 543, 551, 421 A.2d 333, 336 (1980), *aff'd in part and rev'd in part*, 501 Pa. 47, 51, 459 A.2d 744, 746 (1983).

*Utah* — In 1978 the Supreme Court used Section 302 and commented that it established a modern rule and represented an improvement over the categorization test of Section 133 in *Clark v. American Standard, Inc.*, 583 P.2d 618, 620 (Utah 1978). Subsequently in *Tracy Collins Bank & Trust Co. v. Dickamore*, 652 P.2d 1314, 1315 (Utah 1982), the court cited Section 302 in support of its application of the creditor and donee categorization test without comment on any differences in the rules or reference to its earlier decision in *Clark*.

*Virgin Islands* — The Third Circuit Court of Appeals applied Section 302 without comment on possible differences from Section 133 but did construe Section 302 to require the intent of both contracting parties in *Williams v. Virgin Island Water & Power Authority*, 672 F.2d 1220, 1227 (3d Cir. 1982).

*Federal Common Law* — The federal courts have not reached a consensus on the use of Section 302 under the federal common law. Some courts have continued to use the creditor and donee categorization test or other prior standards. *See, e.g.*, *Williams v. Fenix & Scission, Inc.*, 608 F.2d 1205, 1208 (9th Cir. 1979); *Falzarano v. U.S.*, 607 F.2d 506, 511 (5th Cir. 1979); *Rogue Valley Stations v. Birk Oil Co.*, 568 F. Supp. 337, 349 (D. Ore. 1983); *Group Health, Inc. v. Schweiker*, 549 F. Supp. 135, 144 (S.D. Fla. 1982).

Of those federal courts applying Section 302, some have emphasized its adoption of a reasonable reliance approach. *Commercial Ins. Co. v. Pacific-Peru Construction Corp.*, 558 F.2d 948, 953-54 (9th Cir. 1977); *Taylor Woodrow Blitman Construction Corp. v. Southfield Gardens Co.*, 534 F. Supp. 340, 343 (D. Mass. 1982). Another court has deemphasized the reliance factor in determining third party rights. *Beverly v. Macy*, 702 F.2d 931, 940 (11th Cir. 1983).

Some federal courts have applied the section as an improved standard but without reference to the reliance factor. *See Holbrook v. Pitt*, 643 F.2d 1261, 1270 (7th Cir. 1981); *Davis v. United Airlines, Inc.*, 575 F. Supp. 677, 680 (E.D.N.Y. 1983); *Harris v. Waikane Corp.*, 484 F. Supp. 372, 378-79 (D. Haw. 1980); *Hebah v. U.S.*, 428 F.2d 1334, 1338 (Ct. Cl. 1970).

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