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Can A Stranger To A Contract Acquire Any Rights Under It? A Primer On Third-Party Beneficiary Law

by Joseph Siprut

Associate, Novack and Macey LLP
and Mitchell L. Marinello

Partner, Novack and Macey LLP
mmarinello@novackandmacey.com

INTRODUCTION

Suppose that a company enters into an agreement with a developer to rent space in a new building currently under design. Suppose further that the contract for the building between the developer and the architect contains a provision stating that the new building will be for the use of all future "tenants," and provides that the architect must consult jointly with the developer and tenants concerning certain design issues. If the architect breaches the agreement with the developer and the building is never constructed, can the tenants sue the architect for damages?

This hypothetical raises a fundamental and important question of contract law: When does a person who is not a party to a contract nevertheless have legal rights under it? This article addresses these and related issues concerning such third-party beneficiary claims.

THIRD-PARTY BENEFICIARY LAW GENERALLY

The well-established rule in the vast majority of jurisdictions is that, if a contract is entered into for the direct benefit of a third person, the third person may sue for a

breach of the contract in his or her own name, even though the third person is not a party to the contract and supplied no contractual consideration. This principle of law is widely accepted throughout the United States, because, in those limited situations in which third-party beneficiary rights exist, allowing a third-party beneficiary to sue the promisor directly is said to increase judicial efficiency by removing the privity requirement, under which the beneficiary must sue the promisee, who in turn must then sue the promisor.¹

With that said, the more difficult question becomes under what circumstances may such third-party claims be brought. Indeed, while third-party claims are generally permitted in all jurisdictions, the criterion is rigorous. The law draws a distinction between *intended* beneficiaries and *incidental* beneficiaries to a contract. Although the former have contractual rights (and can bring suit), the latter do not.² The test a non-party must meet to qualify as an intended beneficiary is strict:

[T]here is a strong presumption that parties to a contract intend that the contract's provisions apply to only them and not to third parties. In order to overcome that presumption, the implication that the contract applies to third parties must be so strong as to be practically an express declaration...Liability to a third-party must affirmatively appear from the contract's language and from the circumstances...at the time of its execution, and cannot be expanded or enlarged simply because the situation and circumstances justify or demand further or other liability.³

Put simply, a non-party stranger to a contract may qualify as a third-party beneficiary when the promisor's liability to

¹ *Olson v. Etheridge*, 177 Ill.2d 396, 404 (1997). See generally 17A Am. Jur. 2d CONTRACTS § 437 (2004).

² *Ball Corp. v. Bohlin Bldg. Corp.*, 187 Ill. App. 3d 175, 177 (1st Dist. 1989). See also, e.g., *Prouty v. Gores Tech. Group*, 121 Cal. App. 4th. 1225, 1232 (3d Dist. 2004); *Zelber v. Lewoc*, 776 N.Y.S.2d 134, 136 (3d Dept. 2004).

³ *Ball Corp.*, 187 Ill. App. 3d at 177 (internal citations omitted).

that non-party affirmatively appears from the language of the contract and from the circumstances at the time of its execution.

It is often said that for a third party to have the right to sue, the language of the contract must state or otherwise affirmatively make clear that the contract was made for the third party's direct benefit.⁴ This is not to be taken lightly. Even when a third-party clearly benefits from a contract, that person will not be deemed a *direct* beneficiary unless the promisor evidences an intent to be directly *liable* to that third-party.⁵

THIRD-PARTY BENEFICIARY LAW IN ACTION

To apply these principles, let's return to the hypothetical that introduced this article. Can the tenant in the first hypothetical bring suit against the architect for breach of the architect's contract with the developer? Probably yes.

The facts of the first hypothetical are based on *People ex re. Resnik v. Curtis & Davis, Architects & Planners, Inc.*⁶ There, the Illinois Building Authority contracted for architectural services in connection with the construction of a building to be leased by the Authority to the State Department of Public Safety (the "Department") for use as a correctional center. The contract made frequent reference to the Department, and directed that the architects consult with the Department concerning the design of the building. The court held that the Department could maintain an action to recover damages for breach of contract as a third-party beneficiary, on the basis of the "unequivocally clear provisions in the contract."⁷

Thus, like the Department, the tenant in our hypothetical may be deemed a third-party beneficiary of the contract. But there is an additional wrinkle in the hypothetical. The under-

lying contract between the developer and architect refers only to "the tenants" — no particular tenant, including the hypothetical plaintiff, is named individually. Is it an obstacle to potential third-party plaintiff claims that the third-parties are referred to as a collective class, rather than individually or by name?

Strictly speaking, the answer is no: the contract on which the third-party grounds his rights need not specifically name a particular third-party beneficiary if it adequately defines a *class* of individual beneficiaries of which the plaintiff is a member.⁸ It is sufficient if the plaintiff is identifiable at the time performance is due as a member of the class intended to be benefitted.⁹ But practically speaking, the fact that the third-party was not named is a factor that cuts against the idea that the third-party was an intended beneficiary in the first place.

For example, in *Altevogt v. Brinkoetter*,¹⁰ plaintiff real estate purchasers brought a third-party beneficiary claim against a real estate developer based on contractual warranties between the developer and the seller of that real estate. The contract at issue was not made part of the record, and the plaintiffs based their claim on the allegation that the developer "knew" the house would be purchased and occupied by third-parties, and the plaintiffs were a member of that class of third-party purchasers. Taking that allegation on its face, the court noted the general rule that third-parties need not be named in the underlying contract in order to have standing as third-party beneficiaries, but nevertheless held that the purchaser must "allege facts which show an intent on the part of the developer to confer the benefit" on the third-party plaintiffs. Because such intent was lacking, the plaintiff's third-party beneficiary claims failed.

⁴ *Barney v. Unity Paving*, 266 Ill. App. 3d 13 (1st Dist. 1994).

⁵ See, e.g., *Kelleher v. Kelleher*, 21 Ill. App.3d 601 (1st Dist. 1974). There, the plaintiff child petitioned the court to compel his father to pay past-due child support under the Illinois Divorce Act in place at the time. The court found that because the statute provided that the payments at issue were to be made to the mother — albeit for the benefit of the child — the child did not have third-party standing. The benefits were deemed to flow directly to the mother and only indirectly to the child, and no third-party action by the child could be maintained.

⁶ 78 Ill.2d 381 (1980).

⁷ *Id.* at 384.

⁸ *Altevogt v. Brinkoetter*, 85 Ill. 2d 44 (1981).

⁹ In fact, a third-party beneficiary may even sue to enforce the terms of the contract even though the beneficiary did not exist at the time of the contract's creation. See, e.g., *Gold v. Ziff Communications Co.*, 322 Ill. App.3d 32, 46 (1st Dist. 2001) (mail-order business not in existence at time of contract was a proper third-party thereto when the contract's terms provided that any future businesses established by the appellant would be direct and intended beneficiaries).

¹⁰ 85 Ill. 2d 44.

THE RULE OF VESTING

In the absence of language in a contract making the rights of a third-party beneficiary irrevocable, the parties to the contract together retain the ability to discharge or modify the rights of third-party beneficiaries, without that third-party's consent, until those rights "vest" in the third-party. Under the so-called "vesting" doctrine, once a third-party beneficiary's rights vest, the original contracting parties can no longer change those rights without the beneficiary's consent.¹¹

Importantly, vesting occurs only when the third-party, without notice of any discharge or modification: (i) materially changes his position in justifiable reliance on the promise; (ii) brings suit on the promise; or (iii) manifests assent to the promise at the request of the promisor or promisee.¹²

For example, in *Olson v. Etheridge*¹³ — a landmark Illinois Supreme Court decision that set forth what is now the majority rule on vesting — a group of business partners sold their company to an outside buyer under an agreement that required the buyer to make installment payments to the partners to finance the sale. Some time thereafter, the buyer decided to assign his interest in the company and his payment obligations to the assignee. Subsequently, the assignee did not pay the partners. Instead, the buyer and assignee entered into a new agreement that purported to discharge any third-party beneficiary rights that the partners may have had under the agreement between the buyer and assignee. After the partners brought suit against the assignees for payments due under the assignment contract, the court was asked to decide whether the partners had any rights against the assignee.

Though the partners may have been intended third-party beneficiaries of the agreement between the buyer and assignee, the attempt of the buyer and assignee to discharge the assignee from his obligation to make payments to the partners would be a valid revocation of third-party rights — *unless* those rights had already vested in the partners. Had they?

Because the lower court had failed to consider this question, the Court remanded. But consider the issue further. Recall that a third-party beneficiary's rights vest only when the third-party, without notice of the discharge or modification: (i) materially changes his position in justifiable reliance on the promise; (ii) brings suit on the promise; or (iii) manifests assent to the promise at the request of the promisor or promisee. Based on the facts of *Olson*, it would appear that any attempt by the partners to bring suit against the assignee would have occurred *after* the discharge of their rights as third-party beneficiaries. Moreover, there is no suggestion that the partners manifested assent to the promise at the request of either the buyer or assignee. Accordingly, unless the partners could successfully allege that they justifiably relied on their status as third-party beneficiaries of the assignment agreement between the buyer and assignee, they would not be able to prevail on those claims against the assignee.¹⁴

CONCLUSION

In sum, to successfully maintain a third-party beneficiary claim, a third-party plaintiff must establish the following:

- There was a valid, legally enforceable contract between the promisor and promisee;
- The contract was undertaken for the direct benefit of the third-party plaintiff — i.e., the promisor's liability to that third-party affirmatively appears from the contract's language and/or from the circumstances at the time of its execution;
- The promisor breached the contract;
- The third-party plaintiff can overcome all defenses to the breach of contract that the promisor might raise; and
- If the promisor and promisee have attempted to modify or discharge the rights of the third-party plaintiff, that the plaintiff's rights had vested before the attempted modification or discharge.

¹¹*Id.* at 404. The question of whether a third-party beneficiary's rights have vested arises when the promisor and promisee — the contracting parties — attempt to vary or discharge the rights of the beneficiary. *Id.*

¹²*Id.* (noting the rationale underlying this rule is that "parties to a contract should remain free to amend or rescind their agreement as long as there is no detriment to a third party who has provided no consideration for the benefit received") (internal citations omitted). See generally 16 *Am. Jur. Proof of Facts* 2d. 55 (2004).

¹³177 Ill.2d 396, 404 (1997).

¹⁴Of course, the partners could still bring claims against the buyer under their original contract.

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CONTACT INFORMATION

Novack and Macey LLP
303 West Madison Street
Chicago, Illinois 60606

T 312 419 6900
F 312 419 6928

www.novackandmacey.com