Welcome to this podcast on Third Party Beneficiaries brought to you by CALI. I am Professor Scott J. Burnham.

Contracts generally involve two parties. This podcast discusses one of the ways that a contract involves third parties. The topic of Third Party Beneficiaries involves a third party trying to enforce one of the promises in the contract.

The issue here is when can a person who is not party to a contract sue to enforce the contract. A good place to start is to look at what promise is being enforced and ask whether the third party may enforce that promise. The answer is one of those rules that is easy to state and hard to apply. The rule can be found in Restatement (Second) of Contracts § 302 and it essentially tells you that the third party can sue if the parties to the contract *intended* them to be a beneficiary to the contract. As we've seen many times in contract law, trying to determine the intent of the parties can be extremely difficult.

Remember that when we say “intent of the parties,” we are generally talking about an objective intent. A good place to start is to look for objective evidence in the language of the contract to see if it expresses the intention of the parties to give that third party rights under the contract. We might also see if the third party is named in the contract. We can also ask whether the performance of that promise runs to the third party. Finally, we can ask whether the promisee of that promise induced the promisor to make that promise in order to benefit the third party or whether they did it for some other reason.

An obvious example is a life insurance contract where I contract with an insurance company that promises to pay my named beneficiary a sum of money if I die. Assume I die and the insurance company doesn't pay my beneficiary -- can my beneficiary sue? Let’s apply those tests. Does the contract say that I wanted that person to benefit? Yes. Is that person named in the contract? Yes. Does the performance of the promise – that is, the insurance company's promise to pay a sum of money -- run to them? Yes, the contract expressly states it would be paid to them. Did I, the promisee of the insurance company's promise, get the insurance company to make that promise with the intention of benefiting the third party? Again the answer would be yes. So that is a simple case where the third party will be a third-party beneficiary with rights to enforce the contract. The first Restatement of Contracts called the third party in this case a donee beneficiary because the promisee is conferring a gift on them. The Restatement (Second) does away with that vocabulary and just calls them an “intended beneficiary.”

Another example where a third party is clearly a beneficiary is when the third party is what the first Restatement calls a creditor beneficiary. A classic example of a creditor beneficiary came up in the famous case of *Lawrence v. Fox*. In that case, Lawrence had loaned $300 to Holly. Holly then loaned $300 to Fox and Fox promised Holly that he would pay Lawrence in order to satisfy Holly’s obligation to Lawrence. Needless to say, Fox did not pay Lawrence. Lawrence could have gone against Holly under the contract between them, but Lawrence instead chose to go after Fox, claiming that he was a third party beneficiary of Fox's promise to pay $300 to him. The court found that indeed Lawrence was a third party beneficiary of that promise. And again I think all those tests are satisfied in the agreement between Holly and Fox -- Lawrence was specifically named in the contract, Fox's performance ran to him, and Holly extracted that promise from Fox with the intent of benefiting Lawrence by getting Fox to pay an obligation that was otherwise owed by Holly. The first Restatement calls Lawrence a creditor beneficiary since performance of the promise would satisfy a debt that was owed to him, but the Restatement (Second) merely calls him an intended beneficiary.

A modern example of the creditor beneficiary arises in real estate transactions where a person buys a house and borrows money from the bank and promises to pay money to the bank. The owner then sells the house to a new buyer and the buyer *assumes* the mortgage -- that is, the new owner agrees to pay the first owner's obligation to the bank. So if the second buyer didn't pay the bank, would the bank have a claim against the second buyer? Applying our tests, the answer would be yes. The first buyer and the second buyer have agreed to make the bank a beneficiary because the second buyer is satisfying a debt that is owed by the first buyer to the bank.

The Restatement (Second) goes on to say that anybody who is not an intended beneficiary is an *incidental beneficiary*. I always say another name for incidental beneficiary is *loser*, because if they're an incidental beneficiary, then they have no claim against the parties to the contract. For example, assume my neighbor has a contract with a painter to paint his unsightly house, which will benefit me because the paint job will increase the value of my property. If the painter refuses to perform that contract, can I sue the painter for breach of contract for not painting my neighbor's house? Obviously I would have benefited had that contract been performed, but I would not satisfy any of the tests to be a third party beneficiary. So the Restatement (Second) would say, yes I would have benefited had that contract been performed but my benefit would have merely been incidental; therefore, I am an incidental beneficiary but I do not have the right to enforce that contract as a third party beneficiary.

Let’s briefly review this podcast. At this point, you should be able to identify when a party is a third party beneficiary of a contract with rights to enforce the contract and when they are merely an incidental beneficiary with no rights to enforce it.

I hope you’ve enjoyed this podcast on Third Party Beneficiaries.

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