

Section 7. Third Party Issues

Third Party Beneficiaries, Delegation/Assignment of Duties, Assignment of Rights

1. Introductory Note

- a. Many times the parties who execute a contract will not be the only persons who will have rights and/or duties under the contract. These third parties fall into three categories: *third party beneficiaries, delegates, or assignees*.

2. Third Party Beneficiaries

- a. **Definition:** A person who is not a party to a contract, but for whom the contract is intended to benefit is referred to as an intended third party beneficiary. If the original parties to the contract did not intend to benefit a third party, but a person nevertheless incidentally benefits from the contract's existence, then this person is referred to as an incidental beneficiary.

b. Rules:

- i. **Incidental Beneficiary Rule:** An incidental beneficiary has absolutely no rights under the contract.
- ii. **Intended Beneficiary Rule:** Absent a contrary provision in the contract, once an intended beneficiary's rights vest, meaning the party becomes aware of the agreement and 1) relies on the contract or 2) brings a claim under the agreement to enforce its provision, there are three consequences:
 1. The original parties to the contract cannot rescind or modify the contract without an intended beneficiary's approval;
 2. An intended creditor beneficiary OR donee beneficiary can sue the promisor for breach if the promisor does not perform under the contract.
 - i. **Note:** The beneficiary will be subject to any defense the promisor would have against the promisee (e.g. promisee never rendered the payment required under the contract, thereby providing the promisor with an excuse for non-performance).
 - b. **Creditor Beneficiary:** A creditor of the promisee for whom the promisee has intended to benefit from the contract in order to extinguish or reduce a debt owed that person.
 - c. **Donee Beneficiary:** A person for whom the promisee has bestowed the benefit of the contract gratuitously.
 - d. **Promisor:** The party who is supposed to render the performance for the beneficiary.
 - e. **Promisee:** The party who to whom the promisor has contracted with to render services for the beneficiary.
 3. An intended creditor beneficiary can sue the promisee for breach if the promisor or the promisee does not perform under the contract.

c. Examples:

- i. **Ex:** Mother contracts with Lawyer to provide legal services for her son, who is being prosecuted for drug possession, and agrees to pay Lawyer a flat fee of \$5,000. Mother tells Son about this arrangement and Son forgoes hiring another attorney. On the date of the first court appearance, Lawyer does not show up, and later calls Mother saying that he will not be performing the legal services unless Mother pays him an additional \$10,000. Son sues Lawyer for breach of contract.
 1. Son will be successful in his suit against Lawyer because he is an intended third party beneficiary whose rights vested when Mother told him about the contract and he relied on it by not hiring another attorney.
- ii. **Ex:** Same facts as above, but the reason Lawyer did not show up to court was because Mother had never paid him the \$5,000 which they had agreed would be paid up-front.
 1. Son will not be successful in his suit against Lawyer because Lawyer has an excuse for not performing (he was never paid).
- iii. **Ex:** Same facts as above, but the reason Mother entered into the contract with Lawyer was to satisfy a debt owed to Son of \$1,000. Son and Mother had agreed that he would excuse the debt owed, "If Mother would find and pay for Son's legal representation." When Lawyer does not show-up because he hasn't been paid, Son files suit against Mother.
 1. Son will be successful in his suit against Mother because he is a creditor beneficiary. Mother was obligated to "find" and "pay for" Son's legal services (accord) and once this performance was rendered the previous debt

would be extinguished (*satisfaction*). Having complied with the terms of their agreement, Son can sue mother for the \$1,000 or the cost of finding new legal representation for himself.

3. Delegation/Assignment of Duties

- a. **Definition:** The transfer a party's obligations under a contract to a third party.
- b. **Rule:** *Absent contrary language in a contract*, an obligor may delegate/assign his contractual duties to a third party *without the consent of the obligee, unless these duties require a special skill OR the obligor was chosen because of his reputation.*
 - i. **Contrary Language:** “*No delegation*” or “*No assignment of duties*”
 - ii. **Obligor:** The party rendering the performance.
 - iii. **Obligee:** The party for whom the performance is rendered.
 - iv. **Delegate:** The party to whom the duties are assigned.
 - v. **Special Skill or Reputation:** The obligee entered into the contract with the obligee on the basis that the obligor possesses a unique skill or reputation for performing the underlying duties.
- c. **Rights of the Obligee Against the Delegating Party**
 - i. **Rule:** **If the delegate fails to perform or performs improperly, the delegating party will be liable to the obligee, unless there has been a novation.**
 1. **Novation:** As discussed in *Section 2*, a novation is an *express agreement between the parties* to a contract to substitute a new party for an existing party to the contract (the new party takes the place of the old party). If there has been a novation then the substituted party no longer remains liable under the contract. The substitute will now be liable.
- d. **Rights of the Obligee Against the Delegate**
 - i. **Rule:** If the delegate **(1) has received compensation** from the delegating party (i.e. a contract exists between the delegate and the delegating party), and **(2) knows** that the performance it is rendering *is for the benefit of a third party*, then *the obligee will have rights against the delegate as a third party beneficiary to the delegate-delagor contract.* If the *delegate has not received compensation* from the delegating party then *the obligee has no rights against the delegate.*
- e. **Examples:**
 - i. **Ex:** Dylan, a world-renowned singer, enters into a contract with Venue to sing at its concert hall for \$50,000. The day before the performance Dylan notifies Venue that he has delegated his duty to perform to Beyonce, another world renowned singer.
 1. This is *not permissible*. Although Beyonce may be as talented as Dylan, the reason Venue chose to hire Dylan was because of his specific reputation.
 - ii. **Ex:** Mechanic enters into a contract with Driver to repair the engine on Driver's car. Mechanic informs Driver that he has delegated this duty to Fixer, an equally qualified mechanic.
 1. This is *is permissible*. While fixing a car does take specialized knowledge, it is a common task and the quality of performance would not be judged by a person's personal taste.
 - iii. **Ex:** Same facts as above, except Fixer does a horrible job, and when the car is returned to Driver it is in a worse condition that it had been before. Driver sues both Fixer and Mechanic.
 1. *Mechanic is liable*, but it is unclear whether Fixer is liable. *Fixer will only be liable* to Driver if **(1)** it received *compensation* from Mechanic, **and (2)** Fixer *knew* that he was working on a third party's car.
 - a. **Note:** In the above example, assuming Fixer is liable, then Driver can go after *both* Fixer and Mechanic.

4. Assignment of Rights

- a. **Definition:** The transfer of a party's *benefits* under a contract to a third party.
- b. **Rule:** An obligee (the party to whom performance is to be rendered) *may freely assign benefits* it is to receive under a contract to a third party, *unless (1) the contract states that such assignments are "void", or (2) the assignment would materially change the duties of the obligor.* If the assignment is valid then the obligor (the party required to render the performance) must provide those benefits to the third party *once it receives notice of the assignment.*
 - i. **Assignor:** The party making the assignment.
 - ii. **Assignee:** The party to whom the assignment is made.

1. **Note:** *An assignee is different from an intended third party beneficiary because the parties to the contract did not originally enter into the contract for the assignee's benefit. Instead the parties entered into the contract for their own benefit, but chose to assign those benefits to someone else.*
 - iii. **No Precatory Language:** In order to be valid the language of the assignment must be definite (i.e. "I assign my rights to ____" or "Pay ____"), and not contain precatory language (i.e. "It is my wish that you assign my rights to ____", or "I would like it if you assigned my rights to ____").
 - iv. **"Void" v. "Prohibited":** If the contract language states that assignments are merely "prohibited", rather than "void", an otherwise valid assignment will not be invalidated, but the assignor will be considered in breach.
 - v. **Requirements Contracts:** Under Article 2, the assignment of a requirements contract will generally not be invalidated as a "material change" to the obligor's (i.e. seller's) duties.
- c. **Assignee's Rights Against the Obligor**
- i. **Rule:** If the obligor fails to provide the benefits to which the assignee is entitled, the assignee can sue the obligor, but is subject to the same defenses the obligor would have against the assignor.
 1. **Note:** If the obligor has been notified of the assignment, but nevertheless has continued to provide the contractual benefits to the assignor instead of the assignee, it will be liable to the assignee, unless the assignor has expressly or impliedly revoked the assignment.
- d. **Assignee's Rights Against the Assignor**
- i. **Rule:** If the obligor fails to provide the benefits to which the assignee is entitled, the assignee will only have rights against the assignor if the assignment was made for consideration or the assignee is a creditor.
- e. **Gratuitous Assignments v. Assignments for Consideration**
- i. **Rule:** Consideration is not required for an assignment to be valid, however whether or not the assignee gave the assignor consideration for the assignment may affect their right to the benefits if the assignor has made multiple assignments. The following rules govern these situations:
 1. The last gratuitous assignment in time prevails over all earlier gratuitous assignments.
 2. The first assignment for consideration prevails over all earlier gratuitous assignments and all later assignments for consideration.
 - a. **Exception:** A later assignment for consideration will prevail over an earlier assignment for consideration if (1) the later assignee was unaware of the earlier assignment, and (2) was the first to receive the benefits from the obligor or a judgment against the obligor.
- f. **Examples:**
- i. **Ex:** Barak contracts with the city of Chicago to be their mayor for \$200,000 a year. Barak notifies Chicago and Michelle that he "assigns his right to receive payment to Michelle." Chicago continues to pay Barak instead of Michelle. Michelle sues Chicago for the remaining payments.
 1. Michelle **will be successful**, because once Chicago (the obligee) was notified of the assignment, it was obligated to pay Michelle (the assignee). However, Michelle will not be able to collect the money that has already been paid to Barak because it appears that he revoked the assignment to the extent Chicago has already paid him.
 - ii. **Ex:** Same facts as above, except the contract between Barak and Chicago provides, "Rights under this contract are **not assignable**." Barak assigns the right to payment to Michelle anyway. Can Michelle collect from Chicago?
 1. **Yes**, but Chicago can sue Barak for breach. If the contract said that assignments were "void" then Michelle would not have the right to collect this money.
 - iii. **Ex:** Does Barak's assignment of his right to payment substantially change Chicago's duties?
 1. **No**. Paying Michelle is just as easy as paying Barak.
 - iv. **Ex:** Same facts as above, except that after Barak assigns his right to payment to Michelle, Barak fails to provide the mayoral services required under the contract. Chicago then refuses to send payment to Michelle. Can Michelle collect these payments?
 1. **No**. Although Michelle is entitled to Barak's payments she is subject to the same defenses that Chicago would have against Barak. As such, Barak's failure to perform provides Chicago with a valid excuse for non-payment.

- v. **Ex:** Same facts as above, but Chicago notifies Barak of that it “assigns its right to Barak’s services to New York City.” Is this permissible?
1. **No.** This would materially change Barak’s (the obligor) duties, because New York is a completely different City which would require make his performance more difficult or at least different than what he originally contracted to provide.
 - a. **Note:** *A party’s ability to assign its right to payment is almost always valid, but assigning services is usually prohibited for reasons illustrated in the last example.*
- vi. **Ex:** Chicago contracted to buy all the police cars it needs in 2010 from Ford for \$20,000 a vehicle. Can Chicago validly assign it rights under the contract to New York?
1. **Yes.** Under Article 2 *requirements contracts are assignable under as long as the assignee’s requirements are not out of line with the assignor’s* (e.g. Chicago likely needed around 10,000 vehicles and New York only needs 500).
- vii. **Ex:** Same facts as the original example (contract between Barak and Chicago for his services). On Jan 1, Barak assigns the right to payment from Chicago to Michelle as a gift. On Feb 2, Barak assigns the same right to Rohm as a gift. On March 3, Barak assigns the same right to Sarah for \$100. On April 4, Barak assigns the same right to Clinton for \$1,000. As of April 4, whom should Chicago pay for Barak’s services?
1. **Sarah.** As the first assignee for consideration she is entitled to the assignment over all gratuitous assignees and later assignees for consideration. The only exception to this would be if Clinton (the later assignee for consideration) did not know of Barak’s assignment to Sarah and was the first to get a judgment against or payment from Chicago.