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Recommended Citation

David M. Summers, *Third Party Beneficiaries and the Restatement (Second) of Contracts*, 67 Cornell L. Rev. 880 (1982)
Available at: <http://scholarship.law.cornell.edu/clr/vol67/iss4/12>

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THIRD PARTY BENEFICIARIES AND THE RESTATEMENT (SECOND) OF CONTRACTS

A third party beneficiary contract arises when two parties enter into an agreement for the benefit of a third person.¹ Traditionally, the requirement of “privity” prevented the third party from enforcing a contract to which he was not a party.² Gradually, courts eroded this requirement, and in some cases allowed third parties to enforce agreements made for their benefit.³ The first Restatement of Contracts fostered this development and sounded the death knell for the privity requirement by formally recognizing that certain third parties had independent rights in some contracts.⁴

Since the recognition of third party beneficiary rights, courts have grappled with two major problems. First, third party beneficiary law should be able to allow equitable recovery without conferring enforcement rights upon every party who might receive some benefit from a contract.⁵ Second, it is important to preserve the rights of the original parties to modify their contract without nullifying the protection of third party rights.⁶

Judicial response before the first Restatement of Contracts had failed to provide an analytical framework for resolving these problems. As a result, courts struggled with various methods of defining and classifying beneficiaries.⁷ The first *Restatement* attempted to supply a theoretical basis for third party recovery by defining two categories of beneficiaries who could enforce a contract: donees and creditors.⁸ Courts soon found, however, that many third party beneficiaries could

¹ For example, *A* and *B* enter into an agreement whereby *A* agrees to give valuable consideration to *C*. *A* is the promisor, *B* is the promisee, and *C* is the beneficiary of the promise. Third party beneficiary law defines the rights of *C* to enforce the provisions of the contract between *A* and *B*. See generally 4 A. CORBIN, CONTRACTS § 276 (1951).

² See note 13 and accompanying text *infra*.

³ See, e.g., *Gifford v. Corrigan*, 117 N.Y. 257, 22 N.E. 756 (1889) (recovery by third party beneficiary is based on equities of the transaction); *Lawrence v. Fox*, 20 N.Y. 268 (1859) (*C* may enforce contract where *A* paid \$300 for *B*'s promise to pay *C*). See also *Myerson v. New Idea Hosiery Co.*, 217 Ala. 153, 115 So. 94 (1927); *I Chung Kee v. Davidson*, 102 Cal. 188, 36 P. 519 (1894); *Dean v. Walker*, 107 Ill. 540 (1883); *McNamee v. Withers*, 37 Md. 171 (1872); *Kaufman v. United States Nat'l Bank*, 31 Neb. 661, 48 N.W. 738 (1891); *Feldman v. McGuire*, 34 Or. 309, 55 P. 872 (1899); *Urquhart v. Brayton*, 12 R.I. 169 (1878); *Tweeddale v. Tweeddale*, 116 Wis. 517, 93 N.W. 440 (1903).

⁴ See notes 21-24 and accompanying text *infra*.

⁵ See notes 79-80 and accompanying text *infra*.

⁶ See notes 16-20, 32-40 and accompanying text *infra*.

⁷ See notes 15-16 and accompanying text *infra*.

⁸ RESTATEMENT OF CONTRACTS § 133 (1932); see notes 21-26 and accompanying text *infra*.

not be classified within the two categories.⁹ Consequently, many courts disregarded the first *Restatement's* categorical approach and searched for other methods of resolving third party claims.¹⁰

The *Restatement (Second) of Contracts* attempts to eliminate the confusion that the first *Restatement* engendered by replacing the categorical approach with a more flexible standard: the "intent to benefit" test.¹¹ The criteria for allowing third party recovery under the *Restatement Second* is ostensibly clear, but the drafters have not presented an adequate methodology for applying the "intent to benefit" test.¹² This Note discusses the *Restatement Second's* approach to third party recovery and suggests methods for judicious resolution of its interpretive difficulties.

I

HISTORICAL BACKGROUND

A. Common-Law Development of Third Party Beneficiary Rights

Although the early common law had denied relief to third parties because they were not in "privity" with the original parties,¹³ American courts gradually recognized the third party beneficiary's right to maintain an action on a contract made for his benefit.¹⁴ In the developmental stages of third party beneficiary law, some courts used a vague "intention" concept to justify decisions based primarily upon equitable grounds.¹⁵ A workable theory of recovery never developed in the com-

⁹ See notes 28-31 and accompanying text *infra*.

¹⁰ See notes 29-31 and accompanying text *infra*.

¹¹ RESTATEMENT (SECOND) OF CONTRACTS § 302 (1979).

¹² See notes 67-104 and accompanying text *infra*.

¹³ See, e.g., *Winterbottom v. Wright*, 152 Eng. Rep. 402 (1842) (breach of contract to keep a mailcoach in repair after its sale did not provide cause of action to injured passenger); *Langridge v. Levy*, 150 Eng. Rep. 863 (1837) (son receiving injuries from exploding gun could not assert contractual claim based on father's purchase contract). Traditionally, a person who was not a party to an agreement could not maintain an action on the contract. In a third party beneficiary contract, the third party furnished no consideration to the contracting parties. Moreover, because the contracting parties could not enforce the contract against the third party, the third party was denied the right to enforce it against the contracting parties. 2 S. WILLISTON, CONTRACTS § 368, at 894-96 (3d ed. 1959).

¹⁴ See note 3 *supra*. Professor Prosser finds that tort law, rather than contract law, provides the foundation for the third party beneficiary's rights.

[T]he absence of "privity" between the parties makes it difficult to found any duty to the plaintiff upon the contract itself. But by entering into a contract with A, the defendant may place himself in such a relation toward B that the law will impose upon him an obligation, sounding in tort and not in contract, to act in such a way that B will not be injured. The incidental fact of the existence of a contract with A does not negative the responsibility of the actor when he enters upon a course of affirmative conduct which may be expected to affect the interests of another person.

W. PROSSER, LAW OF TORTS § 93, at 622 (4th ed. 1971) (footnotes omitted).

¹⁵ See, e.g., *Austin v. Seligman*, 18 F. 519 (C.C.N.Y. 1883) (parties must intend to treat third party as person primarily interested); *Simpson v. Brown*, 68 N.Y. 355, 362 (1877) ("con-

mon law.

As third party beneficiary recovery became more prevalent, courts also faced cases in which the contracting parties had attempted to modify or rescind the contract in a fashion that affected the beneficiary's rights.¹⁶ These courts had to determine when contract rights vested in a beneficiary. Most of these early cases involved beneficiaries of insurance contracts.¹⁷ Because most insurance contracts were silent about the insured's rights to change beneficiaries,¹⁸ equitable considerations prompted courts to prevent the insured from modifying the contract without the beneficiary's consent.¹⁹ Thus, the beneficiary in these cases acquired a vested right to the proceeds of the insurance policy upon the making of the contract.²⁰

tract must be made [with third party's] benefit as its object, and he must be the party intended to be benefitted.").

Often, these courts would use general labels to identify "intended" beneficiaries. For example, at least one court required that the contracting parties be "actuated by a desire" to benefit the third party. *American Exch. Bank v. Northern Pac. R.R.*, 76 F. 130, 130 (C.C. Wash. 1896) (promise of *A* to pay existing business debt of *B* to *C* was unenforceable because there was no intention to benefit *C*). In addition, third parties could enforce the contract when the contract was made "largely and primarily" or "directly" for the third person's benefit. *See, e.g., Maumee Valley Elec. Co. v. Toledo*, 13 F.2d 98, 104 (6th Cir. 1926) (promise by state to protect water privileges was made for third party's benefit); *Smith v. Wilson*, 9 F.2d 51, 52 (10th Cir. 1925) (third party creditors allowed to maintain action upon purchase contract containing explicit provisions for their "direct" protection). *See also Note, Intent and Benefit in Third Party Beneficiary Contracts: A Justification for Public Policy*, 26 VA. L. REV. 778, 779-82 (1940).

¹⁶ *E.g. Tweeddale v. Tweeddale*, 116 Wis. 517, 93 N.W. 440 (1903) (contract for sale of land calling for payments to third party family members could not be modified without beneficiaries' consent). *See also note 17 infra.*

¹⁷ *See, e.g., Central Nat'l Bank v. Hume*, 128 U.S. 195 (1888); *Denike v. Metropolitan Life Ins. Co.*, 86 Cal. App. 493, 26 P. 322 (1927); *Johnson v. New York Life Ins. Co.*, 56 Colo. 178, 138 P. 414 (1914); *Allen v. Home Nat'l Bank*, 180 A. 498 (Conn. 1935); *Stringfellow v. Alexander*, 96 Fla. 1, 117 So. 899 (1928); *Henrich v. Prior*, 84 Ind. App. 211, 146 N.E. 865 (1925). *See generally Note, The Interest of the Beneficiary of a Life Insurance Policy*, 12 COLUM. L. REV. 551 (1912).

¹⁸ *Id.; see Page, Power of the Contracting Parties to Alter a Contract for Rendering Performance to a Third Person*, 12 WISC. L. REV. 141, 168 (1937). *See also L. FULLER, BASIC CONTRACT LAW* 578-79 (1947).

¹⁹ Professor Fuller has explained the equitable justification for the insurance beneficiary rule. The insured often paid for the policy out of family funds, usually with family members as the policy beneficiaries. Consequently, the family maintained a lower standard of living to allow the insured to pay the premiums on the policy. Modification of the policy by the insured, without express power to do so, would deprive the beneficiaries of the policy reserve that they had "helped" accumulate and upon which they had relied. L. FULLER, *BASIC CONTRACT LAW* 578 (1947). Insurance companies responded to this rule by inserting contract clauses that reserved the right of the insured to change the beneficiary at will. *See Page, supra note 18*, at 177. *See also COUCH ON INSURANCE* 2d § 28:37, 28:45 (1960).

²⁰ *See, e.g., Central Nat'l Bank v. Hume*, 128 U.S. 195, 206 (1888) ("[An insurance] policy and the money to become due under it, belong, the moment it is issued, to the person or persons named in it as the beneficiary or beneficiaries. . . ."). *See also cases cited in note 17 supra.*

B. *The First Restatement of Contracts*

1. *Rights of Third Parties to Enforce Contracts*

The first Restatement of Contracts addressed both the third party's right to enforce a contract, and the original parties' right to make subsequent modifications. The drafters attempted to eliminate the confusion in third party beneficiary law by recognizing two classes of third party beneficiaries: "donees," who were recipients of a "gift promise,"²¹ and "creditors," who were recipients of a "promise to discharge the promisee's duty."²² Under the first *Restatement*, a third party was a donee beneficiary

if it appear[ed] from the terms of the promise in view of the accompanying circumstances that the purpose of the promisee in obtaining the promise . . . [was] 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.²³

Alternatively, a third party was a creditor beneficiary "if no purpose to make a gift appear[ed] from the terms of the promise . . . and performance of the promise [satisfied] an actual or supposed or asserted duty of the promisee to the beneficiary."²⁴ Third parties not falling within one of these categories were incidental beneficiaries²⁵ and had no rights under the contract.²⁶ Perhaps sensing the restrictiveness of these categories, the drafters of the first *Restatement* attempted to amplify them in the Comments.²⁷ This attempt, however, could not remedy the inadequa-

²¹ RESTATEMENT OF CONTRACTS § 133(2) (1932).

²² *Id.*

²³ *Id.* § 133(1)(a). The Explanatory Notes to § 133 are also helpful:

[In the case of a donee beneficiary] there is an actual purpose on the part of the promisee in entering into the contract that the transaction shall benefit the beneficiary. Usually the performance is intended as a gift by the promisee to the beneficiary, as in the case of a life insurance policy for the benefit of the wife or children of the insured.

RESTATEMENT OF CONTRACTS § 133, Explanatory Notes (Official Draft to chs. 1-7 (1928)).

²⁴ RESTATEMENT OF CONTRACTS § 133(1)(b) (1932). The Explanatory Notes provide further clarification:

The second type of contract is where the promisor undertakes to pay a debt of the promisee. In such cases the ordinary purpose of the promisee is to benefit himself by being freed from liability. He has no intent to make a gift to his creditor nor is it material to him whether his creditor acquires a right against the promisor. But whether there is or is not an intention that the creditor shall have such a right most American courts give it to him.

RESTATEMENT OF CONTRACTS § 133, Explanatory Notes (Official Draft to chs. 1-7 (1928)).

²⁵ RESTATEMENT OF CONTRACTS § 133(1)(c) (1932).

²⁶ *Id.* § 147.

²⁷ In the donee beneficiary context, a gift was defined broadly as "some performance or right which is not paid for by the recipient and which is apparently designed to benefit him." RESTATEMENT OF CONTRACTS § 133, Comment c (1932). A creditor beneficiary could enforce all "acts or forbearances undertaken by the promisor" whether or not a discharge of a legal duty resulted. *Id.*, Comment b.

cies of the two-category structure.

Soon after the adoption of the *Restatement*, it became clear that many third party beneficiaries did not fall within either the "donee" or "creditor" beneficiary categories.²⁸ The *Restatement* offered little guidance to courts where the beneficiary defied ready classification. The *Restatement's* category structure, therefore, could not explain the result in many cases.²⁹

The inadequacies of the categorical approach prompted a varied judicial response. Some courts interpreted the categories restrictively;³⁰ other courts allowed third party recovery despite the categories, often-times to achieve an equitable result.³¹ In general, the *Restatement's* cate-

²⁸ See, e.g., *Hamill v. Maryland Casualty Co.*, 209 F.2d 338 (10th Cir. 1954) (surety company, which was neither donee nor creditor under *Restatement* definitions, acquired enforceable beneficial interest in contract between financier and construction company); *McCain v. Stephens*, 80 Ariz. 306, 297 P.2d 352 (1956) (farmer, for whose benefit cropper's lease agreement was made, could sue parties to contract for breach whether or not he was a donee or creditor beneficiary). See also A.L.I. PROCEEDINGS 305-06 (1967) (discussing weaknesses in *Restatement's* two-category structure).

Furthermore, the first *Restatement's* inability to explain many earlier cases revealed flaws in its categorical approach. For example, in *Palmetto Fire Ins. Co. v. Conn.*, 272 U.S. 295 (1926), the Supreme Court held that an insurance contract between an automobile manufacturer and an insurance company was enforceable by a subsequent auto purchaser. The purchaser was not a donee beneficiary because the insurance premium was included in the price of the car. The purchaser was also not a creditor beneficiary, because when the promise was made, the performance of the insurer's promise would not satisfy a present or future obligation of the promisee. The promisee had no obligation until a claim arose. Rather, the Court based its holding on the auto manufacturer's intent to benefit future purchasers—a result that the *Restatement's* category structure did not directly explain.

²⁹ Disputes in private construction contracts illustrate the limitations of the *Restatement's* categorical approach. Subcontractors, as beneficiaries of a surety bond given by the prime contractor to the owner, often directly sue the owner for the value of their services. See generally Comment, *Contracts for the Benefit of Third Parties in the Construction Industry*, 40 FORDHAM L. REV. 315, 320-26 (1971). A subcontractor in this situation is not a donee beneficiary because the contractor's promise, for which he obtained a surety bond, cannot be viewed as a gift to the subcontractor and does not confer a right upon him. See RESTATEMENT OF CONTRACTS § 133(1)(a) (1932). Similarly, the subcontractor is not a creditor beneficiary because neither the owner nor the contractor owed a duty to the subcontractor when they entered into the contract. See *id.* § 133(1)(b). Nevertheless, courts have allowed the subcontractor to recover in these circumstances. See, e.g., *Crane v. New York World Telegram Corp.*, 308 N.Y. 470, 126 N.E.2d 753 (1955) (materialmen may recover under payment bond furnished to contractor by subcontractor).

³⁰ See, e.g., *Isbrandsten Co. v. Longshoremen's Local 1291*, 204 F.2d 495, 497 (3d Cir. 1953) (shipper is not creditor or donee beneficiary of collective bargaining agreement between unloading company and union); *United States v. Inorganics, Inc.*, 109 F. Supp. 576, 580-81 (E.D. Pa. 1952) (government is not intended beneficiary of contract for sale of land, where one party agreed to assume income tax liability of other party but no liability had arisen at time of property transfer); *Ridder v. Blenthen*, 24 Wash. 2d 552, 555, 166 P.2d 834, 835-36 (1946) (third party was incidental, not donee beneficiary of agreement to devise stock of closely-held business).

³¹ See, e.g., *Parks v. Prudential Ins. Co.*, 103 F. Supp. 493, 496 (E.D. Tenn. 1951) (employee who continued to pay insurance premiums on disability policy that employer had discontinued was allowed to recover for disabilities); *Marranzano v. Riggs Nat'l Bank*, 184 F.2d 349 (D.C. Cir. 1950) (employees allowed to enforce provisions of collective bargaining

gory structure failed to provide a workable methodology for analyzing the rights of third parties attempting to enforce a contract made for their benefit.

2. *Modification of Third Party Beneficiary Contracts*

Under the first *Restatement*, the contracting parties' right to modify or discharge the original contract depended on whether the beneficiary fell within the donee or creditor category. If the third party was a creditor beneficiary, the contracting parties were free to modify their agreement, unless the third party had changed his position materially in reliance on the contract or had brought an action to enforce the contract.³² In contrast, the donee's rights under a third party beneficiary contract vested immediately upon the making of the contract and could not be modified without the beneficiary's consent.³³ This inconsistent treatment led to judicial and scholarly dissatisfaction with the *Restatement's* policies on modification of third party contracts.

The drafters of the first *Restatement*, in granting donee beneficiaries rights that vested immediately, relied on prior insurance cases that had prevented modification of insurance contracts without the consent of the beneficiary.³⁴ These precedents, however, did not support extending to all donee beneficiaries the protection formerly given only to insurance

agreement that stated it was made on behalf of all employees); *Coxhead v. Winsted Hardware Mfg. Co.*, 4 F.R.D. 448 (D. Conn. 1945) (sales manager permitted to sue employer as express trustee on behalf of salesmen for breach of contract that provided for employer to pay certain salesmen's commissions). *See also* note 28 *supra*; *McCain v. Stephens*, 80 Ariz. 306, 311, 297 P.2d 352, 355 (1956) ("Whether [the third party] was a donee beneficiary or a creditor beneficiary is immaterial. In either capacity he has the right to maintain this action.').

³² A discharge of the promisor by the promisee in a contract or a variation thereof by them is effective against a creditor beneficiary if,

(a) the creditor beneficiary does not bring suit upon the promise or otherwise materially change his position in reliance thereon before he knows of the discharge or variation, and

(b) the promisee's action is not a fraud on creditors.

RESTATEMENT OF CONTRACTS § 143 (1932).

³³ Unless the power to do so is reserved, the duty of the promisor to the donee beneficiary cannot be released by the promisee or affected by any agreement between the promisee and the promisor, but if the promisee receives consideration for an attempted release or discharge of the promisor's duty, the donee beneficiary can assert a right to the consideration so received, and on doing so loses his right against the promisor.

Id. § 142.

³⁴ The authority on which the first four lines of [section 142] are based consists of life insurance cases. Indeed, by far the greater number of all decisions on donee beneficiaries are life insurance cases. In such cases it is well settled that the beneficiary of the policy immediately acquires a vested right of which he cannot subsequently be deprived unless the policy reserves the right to change the beneficiary.

RESTATEMENT OF CONTRACTS § 142, Explanatory Notes (Official Draft to chs. 1-7 (1928)); *see* notes 16-20 and accompanying text *supra*.

beneficiaries.³⁵ The first *Restatement* placed the donee beneficiary, who did not have an original claim against the promisee, in a better position than the creditor beneficiary who was entitled to performance from the promisee before the third party contract ever existed.³⁶

Commentators were critical of the *Restatement's* position³⁷ and most courts refused to follow the *Restatement's* modification rule as it applied to donee beneficiaries.³⁸ Instead, they treated all third party beneficiaries under the general creditor-beneficiary rule,³⁹ which allowed modification of the contract unless the third party had materially changed his position in reliance upon the contract or had brought suit upon it.⁴⁰

³⁵ See notes 17-20 and accompanying text *supra*. Insurance companies' practice of reserving the insured's right to change the beneficiary further undermined the drafter's reliance on a common-law rule that no longer carried practical application. See note 19 *supra*.

³⁶ See Page, *supra* note 18, at 142-49. See also notes 32-33 *supra*.

³⁷ See Page, *supra* note 18, at 184 (contending that the donee beneficiary has given "no consideration in the past, gives none in the present, and promises nothing in the future" and that "ethical or economic considerations" do not support granting donee beneficiaries preferential treatment); Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406, 421 (1957).

³⁸ See, e.g., *McCulloch v. Canadian Pac. Ry.*, 53 F. Supp. 534, 545 (D. Minn. 1943):

While it must be recognized that the *Restatement* assumes to lay down the broad rule that a third party donee beneficiary contract cannot be rescinded without the donees consent, this rule is not followed in the majority of the courts The only condition laid down by the majority of courts with reference to the rescission of a donee beneficiary contract is that there must be an absence of reliance on the contract by the third party beneficiary.

Cf. Wolosoff v. Gadsden Land & Bldg. Corp., 245 Ala. 628, 18 So. 2d 568 (1944) (contract between employer and housing authority for construction of employees' houses revocable for employees who had not exercised their right of option); *Mitchell v. Marklund*, 238 Cal. App. 398, 47 Cal. Rptr. 756 (1965) (divorced parents allowed to change wills by mutual agreement and alter children's benefits originally set by divorce agreement).

Courts did, however, follow the *Restatement's* position when the donee beneficiary was a minor. See, e.g., *Spates v. Spates*, 267 Md. 72, 296 A.2d 581 (1972) (for purpose of statute of limitations, court assumes that contracting parties' minor son has vested interest as donee beneficiary, although son could not establish change in position). See also note 64 and accompanying text *infra*. A few courts, however, did follow the *Restatement* position in traditional donee beneficiary cases. See *Rohrbacher v. Citizens Bldg. Ass'n*, 40 N.E.2d 157, 161 (Ohio App. 1941) (third-party survivor of depositor allowed to recover amounts due under a certificate of deposit payable to the depositor), *aff'd*, 138 Ohio St. 273, 34 N.E.2d 751 (1941); *Logan v. Glass*, 136 Pa. Super. 221 228-29, 7 A.2d 116, 119 (1939) (third party allowed to recover from grantee who accepted deed requiring payment of money to third party).

³⁹ See note 32 and accompanying text *supra*.

⁴⁰ See, e.g., *Hodges v. Southern Bldg. & Loan Ass'n*, 166 Miss. 677, 148 So. 223 (1933) (mortgagee had no claim against third party based upon an agreement between mortgagor and third party because mortgagee had not accepted or ratified the agreement); *First Carolinas Joint Stock Land Bank v. Du Bose*, 181 S.C. 40, 186 S.E. 514 (1936) (both grantee and mortgagor could rescind agreement to assume payment of mortgage debt because mortgagee had not accepted agreement). See also Page, *supra* note 18, at 158.

II

THE RESPONSE OF THE AMERICAN LAW INSTITUTE IN THE
RESTATEMENT (SECOND) OF CONTRACTSA. *Major Aspects of the Restatement Second*1. *The "Intent To Benefit" Test*

The drafters of the *Restatement Second* confronted an overwhelming number of cases allowing recovery to third party beneficiaries who did not fit into either the donee or creditor category.⁴¹ One of the drafters' objectives was closer conformity with the third party beneficiary cases decided after the first *Restatement*.⁴² Two major alternative approaches were possible. One was the addition of new categories designed to include those third party beneficiaries that the first *Restatement* categories omitted; the other was formation of an analytical framework that would enable the courts to determine properly which third party beneficiaries should be entitled to recover.⁴³

An expansion of the number of categories would have been unworkable. Cases after the first *Restatement* had demonstrated that a categorical approach was too simplistic to deal with novel and complex factual situations; courts were often forced to place new cases into old categories.⁴⁴ This lack of flexibility precluded an expanded categorical approach.⁴⁵ An analytical framework, on the other hand, would be free from the constraint of narrow categories and would be readily adaptable to new situations. This solution, however, posed the danger of being ambiguous and difficult to apply.⁴⁶

⁴¹ See notes 28-31 and accompanying text *supra*.

⁴² See J. MURRAY, CONTRACTS § 3, at 7 (1974).

⁴³ See ALI PROCEEDINGS 305-307 (1967).

⁴⁴ See notes 28-29, 31 and accompanying text *supra*.

⁴⁵ Professor Robert Braucher, a Reporter for the Restatement (Second) of Contracts, discussed the problems that the drafters of this section encountered. In his opening address to the American Law Institute in 1967, he noted that "my first draft for the Restatement Second of this Section [now section 302] simply carried forward what we had before, but I tried to expound a little what the differences were, and I came to some difficulties . . ." *Id.* at 305. Referring to cases in which use of the term "donee" was not appropriate, he added:

So, having wrestled with these fringe cases that did not fit, at one point we came up with three categories. We had donee beneficiaries and creditor beneficiaries and other beneficiaries who have rights. Then we kept the concept of the incidental beneficiary, who does not get rights. After struggling with this for a bit, we began to reexamine the position . . .

Id. at 306. He then explained that the distinctions only made a substantive difference in what is now § 311:

[W]e wondered whether this apparatus and this struggle to make a definition was worth the trouble, and the conclusion of the advisory group is that it is not . . . Then we had to find a new name which would cover both the creditor beneficiary and the donee beneficiary and the other beneficiary, and we fastened on the words "intended beneficiary."

ALI PROCEEDINGS 306-07 (1967).

⁴⁶ On the difficulty in applying a pure "intention" standard, see Note, *Third Party Benefi-*

In the end, the drafters chose a combination of these two approaches. They adopted an "intent to benefit" test, while at the same time utilizing certain categories of recovery.⁴⁷ Section 302 of *Restatement Second* provides:

- (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.⁴⁸

Under this approach, the court examines the intentions of the parties to the original contract in order to evaluate the third party's claim.⁴⁹

The *Restatement Second* avoided the terms donee and creditor in its provisions because they "carry overtones of obsolete doctrinal difficulties."⁵⁰ Nevertheless, in its method for determining when a beneficiary is intended, the *Restatement Second* tracks the language of the first *Restatement's* donee and creditor categories.⁵¹ In fact, the terms themselves are found in the Comments to section 302.⁵² These Comments reflect the

ciaries and the Intention Standard: A Search for Rational Contract Decision Making, 54 VA. L. REV. 1166, 1171-72 (1968).

⁴⁷ See note 52 and accompanying text *infra*.

⁴⁸ RESTATEMENT (SECOND) OF CONTRACTS § 302 (1979).

⁴⁹ See *Harris v. Waikane Corp.*, 484 F. Supp. 372, 379 (D. Hawaii 1980) ("If two parties to a contract intend to benefit a group or class of people, and intend performance to run to that group or class, that is all that is required for that group to attain the status of third party beneficiaries.").

⁵⁰ RESTATEMENT (SECOND) OF CONTRACTS §§ 302-315, Introductory Note, at 438-39 (1979).

⁵¹ Compare RESTATEMENT OF CONTRACTS § 133 (1932) with RESTATEMENT (SECOND) OF CONTRACTS § 302 (1979). See notes 23-25, 48 and accompanying text *supra*.

⁵² Comment b to § 302 states:

Promise to pay the promisee's debt. The type of beneficiary covered by Subsection (1)(a) is often referred to as a "creditor beneficiary." In such cases the promisee is surety for the promisor, the promise is an asset of the promisee, and a direct action by beneficiary against 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.

RESTATEMENT (SECOND) OF CONTRACTS § 302, Comment b (1979). Comment c to § 302 states:

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, 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 contact or communication with the beneficiary essential.

drafters' desire that the "intent to benefit" test be interpreted more broadly than the original donee and creditor categories.⁵³ In addition, use of the terms serves a dual purpose. First, they aid the courts in their interpretation of the phrase "intent to benefit" by recognizing prior court decisions based on the first *Restatement's* distinction between the terms.⁵⁴ Second, the terms provide a reference point for courts finding the distinction helpful in other contexts.⁵⁵

The *Restatement Second's* "intent to benefit" test resolves many of the problems encountered under the first *Restatement's* approach.⁵⁶ Proper application of the test should promote better understanding of the obligations that flow from a third party contract.⁵⁷ It is not surprising that the tentative provisions of the *Restatement Second* met with approval in both state⁵⁸ and federal⁵⁹ courts. The *Restatement Second's* approach po-

RESTATEMENT (SECOND) OF CONTRACTS § 302, Comment c (1979).

⁵³ See RESTATEMENT (SECOND) OF CONTRACTS § 302, Comment d (1979):

Other intended beneficiaries. 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. Other cases may be quite similar in this respect. Examples are a promise to perform a supposed or asserted duty of the promisee, a promise to discharge a lien on the promisee's property, or a promise to satisfy the duty of a third person. 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. Where there is doubt whether such reliance would be reasonable, considerations of procedural convenience and other factors not strictly dependent on the manifested intention of the parties may affect the question whether under Subsection (1) recognition of a right in the beneficiary is appropriate. In some cases an overriding policy, which may be embodied in a statute, requires recognition of such a right without regard to the intention of the parties.

⁵⁴ See note 30 *supra*. This recognition will enable courts to integrate decisions made under the first *Restatement* with new third party beneficiary cases.

⁵⁵ See, e.g., *Luce v. United States*, 444 F. Supp. 347, 353 (W.D. Mo. 1977) ("While the distinction between creditor and donee third party beneficiaries has been discarded for contract law purposes, . . . the Court views the distinction as helpful in the instant case.").

⁵⁶ It avoids the necessity of classifying factual situations into narrow, rigid categories. It also recognizes the equitable claims of beneficiaries who would have been unable to recover under the first *Restatement's* categories.

⁵⁷ The variety of approaches adopted by courts dealing with third party claims illustrates the need for greater understanding and consistency in this area of the law. See notes 15, 28-31 and accompanying text *supra*.

⁵⁸ See, e.g., *Stowe v. Smith*, 42 Conn. L.J. 46, 441 A.2d 81 (1981) (alleged beneficiary of a will entitled to state cause of action against attorney based upon his contract to draft will for beneficiary's mother); *Bush v. Upper Valley Telecable Co.*, 96 Idaho 83, 524 P.2d 1055 (1973) (city resident who subscribed to cable television service was an intended third party beneficiary of a franchise contract between city and cable service); *Resnik v. Curtis & Davis, Architects & Planners, Inc.*, 78 Ill. 2d 381, 400 N.E. 2d 918 (1980) (state may enforce agreement between Illinois Building Authority and contractor for construction of correctional facility where contract defined state as ultimate user of the facility); *Choate, Hall & Stewarr v. SCA Servs., Inc.*, 378 Mass. 535, 392 N.E.2d 1045 (1979) (law partnership allowed to maintain suit to recover fees as third party beneficiary of settlement between partnership's client and defendant-corporation); *Gallo v. Division of Water Pollution Control*, 374 Mass. 278, 372 N.E.2d 1258 (1978) (landowners not intended beneficiaries of contracts between Metropoli-

tentially offers a consistent rationale for third party beneficiary cases falling outside the first *Restatement* categories,⁶⁰ and for the new and complex factual situations likely to arise in the future.

2. *Elimination of the Automatic Vesting Provisions*

The new approach of the *Restatement Second* provided an appropriate opportunity to eliminate the automatic vesting provisions applicable to donee beneficiaries under the first *Restatement*.⁶¹ The *Restatement Second* allows the promisor and the promisee to discharge or modify a duty to an intended beneficiary unless an express term in the original contract provides to the contrary.⁶² If the contract is silent, however, "[s]uch a power [to modify or discharge] terminates when the beneficiary, before he receives notification of the discharge or modification, materially changes his position in justifiable reliance on the promise or brings suit on it or manifests assent to it at the request of the promisor or promisee."⁶³

tan Water District Commission and municipalities to maintain sewerage system); *Snyder v. Freeman*, 300 N.C. 204, 266 S.E.2d 593 (1980) (plaintiff may state a cause of action as third party beneficiary of implied contract between defendant signatories to shareholders agreement and corporation); *Graham & Hill v. Davis Oil Co.*, 486 P.2d 240 (Wyo. 1971) (court denies water-hauling contractor's claim that was based on contract between drilling company and oil company).

⁵⁹ See, e.g., *Commercial Ins. Co. of Newark, N.J. v. Pacific-Peru Constr. Corp.*, 558 F.2d 948, 953-54 (9th Cir. 1977) (reinsurer is third party beneficiary of indemnity agreement between corporation and original insurance company); *Roberts v. Cameron-Brown Co.*, 556 F.2d 356 (5th Cir. 1977) (court denies mortgagor's third party claim founded on agreement between Federal National Mortgage Administration and private lender); *Heyboer v. Kolberg*, 493 F. Supp. 137 (W.D. Mich. 1980) (no finding of intent to benefit bank claiming to be third party beneficiary of agreement among farmer, auctioneer, and Farm & Home Administration); *Harris v. Waikane Corp.*, 484 F. Supp. 372 (D. Hawaii 1980) (group planning vacation on yacht charter may recover based on contract between yacht owner and charter service); *Harrison v. Housing Auth. of College Park*, 445 F. Supp. 356 (N.D. Ga. 1978) (court denies third party beneficiary claim of discharged employee that was based on Annual Contributions contract between local housing authority and Department of Housing and Urban Development), *aff'd per curiam*, 592 F.2d 281 (5th Cir. 1979).

⁶⁰ See notes 28-29, 31 and accompanying text *supra*.

⁶¹ Because the first *Restatement* treated donees and creditors differently, consolidation of the two categories required that the drafters of the *Restatement Second* adopt one rule for the new category. Courts had generally ignored the automatic vesting provisions and treated the donee under the creditor-beneficiary rule. The drafters, therefore, adopted the creditor-beneficiary rule for all beneficiaries under the "intent to benefit" test, but carved an exception for infant beneficiaries. See notes 37-40 and accompanying text *supra*; notes 64-65 and accompanying text *infra*.

⁶² Section 311 provides in part:

(1) Discharge or modification of a duty to an intended beneficiary by conduct of the promisee or by a subsequent agreement between promisor and promisee is ineffective if a term of the promise creating the duty so provides.

(2) In the absence of such a term, the promisor and promisee retain power to discharge or modify the duty by subsequent agreement.

RESTATEMENT (SECOND) OF CONTRACTS § 311 (1979).

⁶³ *Id.* § 311(3). It is also important to note the relationship between § 311 and § 90 of the *Restatement Second*. Section 90 deals with promissory estoppel and provides that "[a] prom-

Under these provisions, the third party must take some action before he can establish an irrevocable claim under the original contract. There is one exception to this rule: When an infant is a third party beneficiary under the *Restatement Second*, there is an inference that the beneficiary's rights are irrevocable.⁶⁴ This exception is based not on the old distinction between donee and creditor beneficiaries, but on the public policy objective in contract law of protecting infants.⁶⁵ In all other situations, the *Restatement Second*, in effect, treats intended beneficiaries under the old creditor-beneficiary rule.⁶⁶

B. *Interpretative Problems After the Restatement Second*

1. *Interpretation of "Intent to Benefit"*

The "intent to benefit" test remedies the categorization problems that courts encountered using the first *Restatement*,⁶⁷ and provides a useful method for determining when a third party should be allowed recovery.⁶⁸ Nonetheless, the *Restatement Second* has failed to explain how to

ise which the promisor should reasonably expect to induce 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 (1979). Although § 90 clearly is concerned with reliance by the promisee, its language suggests that it is not necessarily limited to a two-party transaction. Arguably, it applies to third parties who have justifiably relied on a promise by a promisor. The reliance that will operate to prevent modification of a contract may relate to the reliance relevant in promissory estoppel cases. For example, many third party contracts of the donee nature are analogous to gift transactions. It is arguable, therefore, that courts should apply § 90. The drafters of the *Restatement Second* have rendered this unnecessary by specifically incorporating "reliance" into § 311. Section 311 also provides that:

(4) If the promisee receives consideration for an attempted discharge or modification of the promisor's duty which is ineffective against the beneficiary, the beneficiary can assert a right to the consideration so received. The promisor's duty is discharged to the extent of the amount received by the beneficiary.

Id. § 311(4).

⁶⁴ *See id.*, Comment d. The first *Restatement* also accorded infants irrevocable rights as third party beneficiaries. Because infants were classified as donee beneficiaries, their rights as third parties vested immediately upon execution of the contract. *See* RESTATEMENT OF CONTRACTS § 142 (1932).

⁶⁵ *See, e.g.*, *James v. Pawsey*, 162 Cal. App. 2d 740, 328 P.2d 1023 (1958) (parties not allowed to rescind agreement to make mutual wills benefiting infant third party); *Rhodes v. Rhodes*, 266 S.W.2d 790 (Ky. 1953) (renegotiation of contract ineffective without consent of infant beneficiary); *Quinn v. Thigpen*, 266 N.C. 720, 147 S.E.2d 191 (1966) (separation agreement between parents confers vested rights on infant beneficiaries).

⁶⁶ *See* RESTATEMENT (SECOND) OF CONTRACTS § 311, Reporter's Note (1979); notes 32, 38-40 and accompanying text *supra*.

⁶⁷ *See* notes 25, 28-31 and accompanying text *supra*.

⁶⁸ For contrary views, see generally Note, *The Third Party Beneficiary Concept: A Proposal*, 57 COLUM. L. REV. 406, 409 (1957) (asserting that "the intent to benefit approach prohibits clear analysis and predictability"); Note, 88 HARV. L. REV. 646, 654 (1975) ("[J]udicial efforts to identify and evaluate the relevant policy considerations are more likely to yield socially desirable results than are mechanical applications of the common law tests for third party beneficiary standing."); Note, *supra* note 46, at 1174 ("The theme of this Note is that courts should cease their preoccupation with intent and look instead to actual reliance and

apply the test. The resulting danger is that the "intent to benefit" test will be interpreted either too restrictively or too broadly.

Courts using the "intent to benefit" test of the *Restatement Second* must not make it unnecessarily restrictive. In donee-type beneficiary cases, the requisite intent on the part of the promisee to make a gift or confer a benefit usually is clear.⁶⁹ In the creditor-type beneficiary cases, however, the promisee's intent is likely to be primarily of benefit to himself through discharge of his own obligation or debt.⁷⁰

Under the first *Restatement*, some courts searched for the primary purpose of the contract.⁷¹ When they found that the contract's primary purpose was to benefit the promisee, these courts concluded that any benefit flowing to a third party was incidental.⁷² This type of analysis is flawed in two ways. First, it ignores the fundamental characteristics of many third party beneficiary contracts. Many contracts have several purposes or intended effects. The parties themselves, especially in commercial settings, often intend that some benefit accrue to a third party, although the "primary" benefit of the contract runs to the original parties.⁷³ Even in the traditional donee-type insurance cases,⁷⁴ arguably the primary benefit still runs to the promisee in terms of the peace of

commercial and social policies as the ultimate criteria for determination of third party beneficiary controversies.").

⁶⁹ In discussing the determination of intent in the donee-type beneficiary cases, Professor Williston asserts: "[T]he promisee usually does wish to make a gift of the benefit of the promise to the third person." 2 S. WILLISTON, *CONTRACTS* § 356A (1959). See also 4 A. CORBIN, *CONTRACTS* § 776 (1951).

⁷⁰ See 2 S. WILLISTON, *CONTRACTS* § 356A (1959) ("But 'in contracts of the creditor type, the main purpose of the promisee is not to confer a benefit on the third party beneficiary, but to secure the discharge of his debt or performance of his duty to the third party.'") (quoting *Hartman Ranch Co. v. Associated Oil Co.*, 10 Cal. 2d 232, 73 P.2d 1163 (1937)). See also 4 A. CORBIN, *CONTRACTS* § 776 (1951) ("In third party cases, the right of such party does not depend upon the purpose, motive, or intent of the promisor.").

⁷¹ See, e.g., *Sachs v. Ohio Nat'l Life Ins. Co.*, 148 F.2d 128, 131 (7th Cir. 1945) (beneficiary of a reinsurance may not recover because agreement was not made "for his direct benefit, or . . . primarily for his benefit."); *Daniel-Morris Co. v. Glen Falls Indem. Co.*, 308 N.Y. 464, 126 N.E.2d 750 (1955) (materialman may sue as third party beneficiary on a payment bond because bond's primary purpose was payment of materialmen); *Waterway Terminals Co. v. P.S. Lord Mechanical Contractors*, 242 Or. 1, 30, 406 P.2d 556, 569 (1965) (subcontractors not third party beneficiaries of fire-insurance policy without proof that contracting parties "had in mind a benefit to anyone other than themselves"). See also Note, 45 VA. L. REV. 1226, 1230 (1959) ("In most cases the application of the strict requirement that the circumstances must show a primary intent to benefit third parties precludes recovery because the contracting parties usually intend only to protect themselves.").

⁷² See note 71 *supra*.

⁷³ See 2 S. WILLISTON, *CONTRACTS* § 347 (1959).

A contract in which the promisor engages [with] the promisee to render some performance to a third person is generally called a contract for the benefit of a third person with little regard to whether the purpose of the promisee in entering into the contract was his own benefit or the benefit of the person to whom performance was to be rendered.

Id.

⁷⁴ See notes 17-20 and accompanying text *supra*.

mind associated with life insurance protection. A finding, therefore, that the parties intend to benefit themselves does not necessarily mean that they do not intend to benefit the third party.⁷⁵ Second, the "primary purpose" approach limits the rights of the original parties to make a contract of their choosing. It may make it impossible for contracting parties to give rights to the third party, unless this purpose is construed to be the "primary purpose" of the contract. Parties often seek to enter into agreements that give third parties specific rights, without making these rights the "primary purpose" of the contract.⁷⁶ In this manner, a "primary purpose" approach would unnecessarily restrict the original parties' freedom of contract.⁷⁷

While guarding against an overly restrictive interpretation of "intent to benefit," courts must also avoid an unnecessarily broad one. The "intent to benefit" test should increase the number of beneficiaries entitled to recover.⁷⁸ The danger, however, is an expansion of this category that would allow recovery to every person who in fact will benefit by a promisor's performance.⁷⁹ This could foster endless litigation brought by persons who might conceivably benefit from the contractual performances of others.⁸⁰ In addition, an overly broad interpretation

⁷⁵ See, e.g., *M.T. Reed Constr. Co. v. Virginia Metal Prods. Corp.*, 213 F.2d 337, 338 (5th Cir. 1954) (general contractor may sue as direct beneficiary of agreement between state building commission and library-bookstack installer); *Fuzie v. Manor Care, Inc.*, 461 F. Supp. 689, 698 (N.D. Ohio 1977) (private nursing home patient may maintain contractual action as beneficiary of nursing home's medicaid provider's agreement with the state); *COAC, Inc. v. Kennedy Engr's*, 67 Cal. App. 3d 916, 920, 136 Cal. Rptr. 890, 892 (1977) ("... it is not necessary that the contract be exclusively for the benefit of the third party to give him a right thereunder nor that he be named and identified as an individual."); *Visintine & Co. v. New York, Chicago & St. Louis R.R.*, 169 Ohio St. 505, 160 N.E.2d 311 (1959) (third party contractor may sue on contract between Ohio and railroad company for damages caused by performance delays).

⁷⁶ See *Ohio Cas. Ins. Co. v. Beckwith*, 74 F.2d 75, 78 (5th Cir. 1934) (parties may intend to confer a benefit upon a third party "although the primary purpose . . . was to benefit themselves"); note 75 *supra*.

⁷⁷ The *Restatement Second* asserts that "... in some situations overriding social policies may limit the parties' freedom of contract." *RESTATEMENT (SECOND) OF CONTRACTS* §§ 302-315, Introductory Note, at 439 (1979). This statement, however, does not imply that seeking the "primary purpose" of the contract serves overriding social policies.

⁷⁸ See note 53 and accompanying text *supra*.

⁷⁹ See *A. MUELLER & A. ROSETT, CONTRACT LAW AND ITS APPLICATION* 498 (1971) ("A broad grant of power to claim under the contract to everyone who could show that he would have been benefitted by a performance, and hence had lost by a breach would have made a shambles of the law."). In addition, it is important to note that the test for third party recovery is not whether there could have been intent to benefit the third party, but whether that intent actually existed. See *RESTATEMENT (SECOND) OF CONTRACTS* § 302(1)(b) (1979).

⁸⁰ A mere incidental benefit from performance of a contract is insufficient to maintain a suit based on the contract. See, e.g., *Ogden Dev. Corp. v. Federal Ins. Co.*, 508 F.2d 583, 588 (2d Cir. 1974) (contractor who submitted proposal for erection of educational and housing facilities merely incidental beneficiary of bond filed by another contractor); *Compagnie Nationale Air France v. Port of New York Auth.*, 427 F.2d 951, 954 (2d Cir. 1970) (airline

could prevent parties from understanding the nature of their obligations in third party contracts.

Comment d to section 302 states that "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."⁸¹ Misuse of this section may lead to overly broad third party recovery. Comment d poses two interpretive difficulties, both of which could potentially override the basic focus of the "intent to benefit" test. First, this Comment may be used to base recovery on the beneficiary's interpretation of a third party contract. A court may concentrate on the beneficiary's reliance without considering the "intentions" of the contracting parties. Improper emphasis on Comment d may overlook the *Restatement Second's* initial and fundamental emphasis on the original contracting parties' "intention to benefit." Second, rather than using the "intent to benefit" language in Comment d, the drafters chose the words "confer a right."⁸² The danger arises that courts will construe the phrase "confer a right on him" to include any person who may benefit from a promise, whether or not that benefit was actually intended to run to the beneficiary.⁸³ If courts attempt to classify beneficiaries by merely looking to the effect of the promise, the intent in the original contract may be overlooked.⁸⁴ Courts should therefore not allow language of Comment d to override the basic focus of section 302.⁸⁵

2. *Whose Intent Should Govern?*

In applying the "intent to benefit" test, courts have disagreed over

seeking to recover for injuries when its airliner nosed over into construction ditch merely incidental beneficiary of airport improvement contract).

⁸¹ RESTATEMENT (SECOND) OF CONTRACTS § 302, Comment d (1979); see note 53 *supra*.

⁸² See text accompanying note 81 *supra*; note 53 *supra*.

⁸³ Compare cases cited in note 80 *supra* with *McClare v. Massachusetts Bonding & Ins. Co.*, 266 N.Y. 371, 379, 195 N.E. 15, 17 (1935) (A promised B to pay D a debt owed by C; court holds that D could enforce the promise, but warns that "[t]he requirement of some obligation or duty running from the promisee to the third party beneficiary has been progressively relaxed until a mere shadow of the relationship suffices, if indeed it has not reached the vanishing point."). See also *Martinez v. Socoma Cos.*, 11 Cal. 3d 394, 521 P.2d 841, 113 Cal. Rptr. 585 (1974) (applying CAL. CIV. CODE § 1559 (West), disadvantaged residents had no right of recovery based on federal government contract providing for training of unemployed persons); *Blair v. Anderson*, 325 A.2d 94, 96-97 (Del. 1974) (federal prisoner was creditor beneficiary of contract between state and federal government providing for incarceration of prisoners); Note, *Martinez v. Sacoma Companies: Problems in Determining Contract Beneficiaries' Rights*, 27 HASTINGS L.J. 137 (1975).

⁸⁴ See note 88 *infra*.

⁸⁵ The basic focus of § 302 is determining if a beneficiary is an intended beneficiary under the contract. "[T]he terms 'intended' beneficiary and 'incidental' beneficiary are used to distinguish beneficiaries who have rights from those who do not." RESTATEMENT (SECOND) OF CONTRACTS §§ 302-315, Introductory Note, at 439 (1979).

whose intent governs a third party contract.⁸⁶ They have usually focused on the promisee's intentions,⁸⁷ but some have emphasized the promisor's intent.⁸⁸ Other courts,⁸⁹ however, and at least one commentator,⁹⁰ require that both parties to the contract intend to benefit the third party.

The *Restatement Second* does not resolve this conflict and may, in fact, add to the confusion. It does not clearly indicate whether the promisee's intention alone should govern, or whether courts must require the intention of both the promisor and the promisee before the third party is an "intended" beneficiary.⁹¹ The confusion stems from ambiguity in the

⁸⁶ Compare *Spires v. Hanover Fire Ins. Co.*, 364 Pa. 52, 56-57, 70 A.2d 828, 830 (1950) ("To be a third party beneficiary entitled to recover on a contract it is not enough that it be intended by one of the parties to the contract and the *third person* . . . but *both parties to the contract* must so intend and must indicate that intention in the contract . . .") (emphasis in original) and *Pennsylvania Liquor Control Bd. v. Rapistan, Inc.*, 472 Pa. 36, 42, 371 A.2d 178, 182 (1976) ("[T]here must still be evidence, sufficient to permit reasonable reliance, that the promisee and promisor intended to confer a right on a third party.") with *Hamill v. Maryland Cas. Co.*, 209 F.2d 338, 341 (10th Cir. 1954) ("[I]t is the intent or purpose of the promisee who pays for the promise that has been generally looked upon as governing.") and *McCulloch v. Canadian Pac. Ry.*, 53 F. Supp. 534, 542 (D. Minn. 1943) ("[T]he courts look primarily to the intent of the promisee."). See also 45 VA. L. REV. 1226, 1228 (1959) ("Depending upon the jurisdiction, it is the intent of the promisee, promisor, . . . or both of the parties that governs. . .").

⁸⁷ See 2 S. WILLISTON, *CONTRACTS* § 356A (1959) ("[I]t is the intent or purpose of the promisee who pays for the promise that has been generally looked upon as governing."). See also note 97 and accompanying text *infra*.

⁸⁸ In *Holbrook v. Pitt*, 643 F.2d 1261 (7th Cir. 1981), housing project tenants, who were beneficiaries of Housing and Urban Development assistance payments, sought recovery of payments allegedly due from the project owner. The owner filed a third party complaint against HUD. The court concluded:

We also decline to adopt the Restatement's position to the extent it may suggest that only the intentions of the "promisee" (the party through whom the beneficiary claims) and not the "promisor" (the party obligated to render performance that benefits the third party) are relevant to a determination of the third-party beneficiary's rights. . . . It is improper to neglect the reasonable expectations of the promisor, since the burden of the agreement to the promisor, and therefore the consideration he will require, may vary according to the number of parties who have enforceable rights under the contract.

Id. at 1271 n.17; cf. *Fruitvale Canning Co. v. Cotton*, 115 Cal. App. 2d 622, 625, 252 P.2d 953, 955 (1953) ("Before a third party who may derive a benefit of a promise is entitled to bring an action thereon there must be an intent clearly manifested by the promisor to secure the benefit claimed to the third person.")

⁸⁹ See, e.g., *Vazman, S.A. v. Fidelity Int'l Bank*, 418 F. Supp. 1084 (S.D.N.Y. 1976) (shipowner could not intervene as third party in action by seller to recover under letter of credit); *Marlboro Shirt Co. v. American Dist. Tel. Co.*, 196 Md. 565, 77 A.2d 776, 778 (1951) (shirt company not allowed to maintain action for water damage to inventory based on contract between owner of shirt company's building and telegraph company); *O'Boyle v. DuBose-Killeen Properties, Inc.*, 430 S.W.2d 273 (Tex. Civ. App. 1968) (real estate broker unable to recover commissions based on an agreement between vendor and purchaser). See also note 86 *supra*.

⁹⁰ See Jones, *Legal Protection of Third Party Beneficiaries: On Opening Courthouse Doors*, 46 U. CIN. L. REV. 313, 320 (1977).

⁹¹ It does seem clear, however, that the intentions of the promisor alone will not suffice for third party recovery if the promisee lacks an intent to benefit the third party. Cases

language of section 302.⁹² In its two-part test for determining when a third party is an "intended beneficiary," section 302(1) refers to the "intention of the parties" under its first requirement,⁹³ but only to the promisee's intention under subsection b of its second requirement.⁹⁴

"Intent to benefit" represents the state of mind with which parties enter into the agreement.⁹⁵ Although this subjective state may be difficult to prove in many situations, the first requirement is easily met in situations in which both contracting parties have a close relationship with the beneficiary and clearly want to confer a benefit on him.⁹⁶ Recognition of the third party's rights in this situation effectuates the subjective intentions of both parties. In many other cases, however, the promisor's motivation for entering into the contract is the consideration received from the promisee.⁹⁷ If courts require that both the promisor and promisee have "intention" under the first part of the test, recovery will effectively be denied to many third party beneficiaries previously entitled to recover. The third party would never be allowed to recover in situations in which the promisor did not subjectively intend to benefit the third party. This may explain why courts have continually focused on the promisee's intentions,⁹⁸ and why some commentators have asserted that the intent of the promisee is "generally looked upon as

allowing recovery by relying on the promisor's intentions have also found an intent by the promisee to benefit the third party. *See* note 88 *supra*.

⁹² RESTATEMENT (SECOND) OF CONTRACTS § 302 (1979); *see* text accompanying note 48 *supra*.

⁹³ RESTATEMENT (SECOND) OF CONTRACTS § 302 (1979) provides in part: "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* . . . (emphasis added). Comment d adds that "[e]ither 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." *Id.*, Comment d (1979) (emphasis added); *see* note 53 *supra*.

⁹⁴ Section 302(1)(b) provides that a beneficiary may be intended where "the circumstances indicate that the *promisee intends* to give the beneficiary the benefit of the promised performance." RESTATEMENT (SECOND) OF CONTRACTS § 302(1)(b) (1979) (emphasis added); *see* text accompanying note 48 *supra*.

⁹⁵ Intent refers to the state of mind with which an act is done or omitted. BLACK'S LAW DICTIONARY 727 (5th ed. 1979).

⁹⁶ Consider a divorce agreement in which the wife promises to give the husband some valuable consideration for the benefit of the children. In return, the husband promises to execute a provision in his will leaving the consideration to the children after his death. This is a contractual agreement for the benefit of the children where both parties would subjectively intend to benefit the children.

⁹⁷ *See* 4 A. CORBIN, CONTRACTS § 776 (1951).

If A buys Blackacre [from] B and promises B to pay the price to C, he makes the promise in order to get Blackacre, not to benefit C; and this is true whether C is a creditor of B's or B's dearly beloved daughter or is in a home for imbeciles.

See also note 104 *infra*.

⁹⁸ *See* note 87 and accompanying text *supra*.

governing."⁹⁹

Furthermore, requiring that the promisor subjectively intend to benefit the third party may contravene the purpose of the section 302 language. If the first part of the test under section 302 requires both parties' subjective intent, a contract satisfying the requirement would automatically satisfy subsection b, which requires only the promisee's intent to benefit.¹⁰⁰ Such a reading would render subsection b unnecessary.

A distinction between the "intent" of the promisee and the "assent" of the promisor would eliminate much of the confusion in this area. Assent in this situation consists of a declaration or other expression by the promisor of willingness to enter into the contract.¹⁰¹ Unlike intent, which is judged by a subjective standard, assent is judged objectively.¹⁰² Accordingly, it is not necessarily as important that the promisor subjectively intend to benefit the third party as it is that he manifest his willingness to be bound by a contract creating rights in the third party.¹⁰³

This approach avoids the difficulty of proving a subjective state of mind which the promisor lacks in most cases anyway.¹⁰⁴ In addition, it provides a workable method for applying the dual requirements of section 302.¹⁰⁵ Courts applying section 302 of the *Restatement Second* should, therefore, require an "intent to benefit" by the promisee and a manifested assent to that intention by the promisor.

⁹⁹ 2 S. WILLISTON, CONTRACTS § 356A (1959); see note 97 *supra*.

¹⁰⁰ See notes 93-94 and accompanying text *supra*.

¹⁰¹ See BLACK'S LAW DICTIONARY 106 (5th ed. 1979).

¹⁰² See RESTATEMENT (SECOND) OF CONTRACTS § 19 (1979). Section 19 provides:

Conduct as Manifestation of Assent

(1) The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act.

(2) The conduct of a party is not effective as a manifestation of his assent unless he intends to engage in the conduct and knows or has reason to know that the other party may infer from his conduct that he assents.

(3) The conduct of a party may manifest assent even though he does not in fact assent. In such cases a resulting contract may be voidable because of fraud, duress, mistake, or other invalidating cause.

See generally *id.* § 18-23.

¹⁰³ See RESTATEMENT (SECOND) OF CONTRACTS § 17 (1979), which provides in part:

[T]he formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.

The promisor and promisee may enter into a third party contract without identical intentions towards the beneficiary. 4 A. CORBIN, CONTRACTS § 776 (1951) ("The two parties have purposes, motives, and intentions; but they never have quite the same ones."). See also note 73 and accompanying text *supra*; J. CALAMARI & J. PERILLO, CONTRACTS § 2-1 (1977); 1 S. WILLISTON, CONTRACTS § 22 (1959).

¹⁰⁴ "In third party cases, the right of such [third] party does not depend upon the purpose, motive, or intent of the promisor. The motivating cause of his making the promise is usually his desire for the consideration given by the promisee. In few cases will he be moved by a desire to benefit a third person." 4 A. CORBIN, CONTRACTS § 776 (1951).

¹⁰⁵ See notes 93-94 and accompanying text *supra*.

3. *Consideration of Surrounding Circumstances*

Another issue likely to arise under the *Restatement Second* is the extent to which courts should go beyond the actual language of the contract to determine if the requisite intent to benefit exists. Some courts have proposed that the determination of intent should be limited to the express language in the contract.¹⁰⁶ Other courts do not limit their inquiry to the terms expressed within the contract; rather, they look to all surrounding circumstances.¹⁰⁷

The focus of section 302 is an accurate determination of the promisee's intention.¹⁰⁸ Courts can best attain this objective by considering all the circumstances that surround the making of the contract. It is not necessary that the intention to benefit a third party be evidenced by a clear contractual provision.¹⁰⁹ In fact, most contracts reaching the courts do not expressly show an intent to benefit the third party.¹¹⁰ Contracting parties often omit important provisions from their written contracts because they rely on prior dealing, trade usage, or other shared beliefs.¹¹¹ These omissions may affect the entire meaning of the contract if they are not considered when interpreting the contract.

Consideration of surrounding circumstances also comports with the

¹⁰⁶ See, e.g., *Johnson v. Holmes Tuttle Lincoln-Mercury*, 160 Cal. App. 290, 297, 325 P.2d 193, 197 (1958) ("The test for determining whether a contract was made for the benefit of a third person is whether an intent to benefit a third person appears from the terms of the contract"); *Silverman v. Food Fair Stores, Inc.*, 407 Pa. 507, 509, 180 A.2d 894, 895 (1962) ("[f]or anyone to be a third party beneficiary entitled to recover on a contract both parties to the contract must so intend and must indicate that intention in the contract."); *Spires v. Hanover Fire Ins. Co.*, 364 Pa. 52, 57, 70 A.2d 828, 831 (1950) (intention to confer benefit on third party must "affirmatively appear in the contract itself"); *Republic Nat'l Bank of Dallas v. National Bankers Life Ins. Co.*, 427 S.W.2d 76, 79 (Tex. Civ. App. 1968) ("It is the intention and purpose of the contracting parties, as disclosed within the four corners of the instrument, which should control."). *But see* *Pennsylvania Liquor Control Bd. v. Rapistan, Inc.*, 472 Pa. 36, 46, 371 A.2d 178, 182 (1976) (agreement between P.L.C.B. and contractor for construction of warehouse conveyor system not intended for benefit of third party); *Texas Bank & Trust Co. v. Lone Star Life Ins. Co.*, 565 S.W.2d 353, 357 (Tex. Civ. App. 1978) (interim financing bank in land purchase arrangement may not recover on commitment letter issued by long-term financier to land purchaser).

¹⁰⁷ See, e.g., *Ross v. Imperial Constr. Co.*, 572 F.2d 518, 521 (5th Cir. 1978) (Third party's "proof, however, is not limited to language appearing on the face of the contract, but also may include testimony as to the circumstances surrounding its making."); *Riegel Fiber Corp. v. Anderson Gin Co.*, 512 F.2d 784, 787 (5th Cir. 1975) (fiber manufacturer allowed to maintain third party beneficiary suit to enforce cotton sellers' contracts with certain farmers); *American Elec. Power Co. v. Westinghouse Elec. Corp.*, 418 F. Supp. 435, 449 (S.D.N.Y. 1976) ("[T]he intent to confer a benefit on a party not named in the contract must be determined not only from the agreement, but from a careful examination of the surrounding circumstances as well.").

¹⁰⁸ See note 105 and accompanying text *supra*.

¹⁰⁹ See 4 A. CORBIN, CONTRACTS § 777 (1951).

¹¹⁰ See notes 73, 104, 107 and accompanying text *supra*.

¹¹¹ See notes 104, 107 and accompanying text *supra*; cf. U.C.C. § 1-205 (defining course of dealing and usage of trade for purposes of commercial transactions).

aim of the drafters of the *Restatement Second*.¹¹² Resolution of this issue is not apparent in the actual text of section 302 or in the official Comments, but the Reporter's Note specifically states that "[a] court in determining the parties' intention should consider the circumstances surrounding the transaction as well as the actual language of the contract."¹¹³ In the future, courts should make the test for determination of "intent to benefit" as expressed in section 302 broad enough to include consideration of circumstances not contained within the actual written agreement.

CONCLUSION

The Restatement (Second) of Contracts has replaced the donee and creditor categories of the first *Restatement* with an "intent to benefit" test as the method for determining when to allow recovery by third party beneficiaries. Certain guidelines not found in the *Restatement Second* are necessary for proper application of the "intent to benefit" test. Courts should not restrict recovery merely because the primary purpose of the contract is not to benefit the third party. In addition, courts should not grant recovery to anyone who can conceivably be classified as an "intended beneficiary" by looking only to the effect of the promise. Courts should focus on the promisee's intent to benefit the third party and the promisor's assent to that intent. Finally, courts should consider all the circumstances surrounding the making of the contract. By adopting these further guidelines, courts using the *Restatement Second* will promote greater predictability and clearer analysis of third party beneficiary claims.

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¹¹² Consideration of all circumstances surrounding the making of a contract will provide a more accurate determination of the intent of the promisee towards the beneficiary. See note 105 and accompanying text *supra*.

¹¹³ RESTATEMENT (SECOND) OF CONTRACTS § 302, Reporter's Note (1979). It is unclear why this explanation was not included in the Official Comments to § 302. In addition, it is also possible that courts may use a "parol evidence rule" analysis to consider evidence of surrounding circumstances in third party beneficiary cases. Under the "rule," evidence may be admitted to supplement a writing which is not intended as a complete expression of the agreement. See RESTATEMENT (SECOND) OF CONTRACTS §§ 213-216 (1979). Accordingly, the "parol evidence rule" could also be used in some third party beneficiary cases to allow admission of evidence other than the written agreement for the purpose of showing that the promisee intended to benefit the third party. See generally J. CALAMARI & J. PERILLO, CONTRACTS §§ 3-1 to 3-15, 98-131 (1970).

