

EXPRESS THIRD-PARTY BENEFICIARY CLAUSES

Avoid Lack of Privity

By Alexis Hailpern and Danielle Waltz

The emergence of modern and specialized inclusions on projects creates an environment where contractors are inundated with various contracts and agreements. Contractors often enter into contractual agreements with subcontractors who enter into contractual agreements with sub-subcontractors. As the typical construction contract chain becomes larger, the contractor and the owner are more and more removed from the basis of the bargain of each contract. Contracts, however remote, that fail to name owners and contractors as express parties to those contracts pose a challenge to enforcement. The remedy? Express third-party beneficiary clauses.

THE DOCTRINE OF PRIVACY

The Doctrine of Privity is a common law principle which bars a person or business from enforcing a contract unless they are an express party to that contract. If not expressly named as a party to a contract, an owner lacks privity of contract when a contractor enters into a contractual agreement with a subcontractor. Likewise, if not expressly named as third-party beneficiaries, an owner and a contractor lack privity of contract when a subcontractor enters into a contractual agreement with a sub-subcontractor.

Lack of privity essentially means lack of ability to enforce a contract. However, most, if not all, states recognize an exception to the Doctrine of Privity concerning third-party beneficiaries. A third-party beneficiary to a contract is one who will benefit from the contract despite not being an express party to a contract. When one proves that they are a third-party beneficiary to a



contract, they may enforce the terms of that contract.

Generally, one who is not an express party to a contract may bring an action regarding the contract, as a third-party beneficiary, if two elements exist. First, the express parties to the contract must have an intention that the contract was to benefit the non-party bringing the action. Next, the benefit claimed must be a direct benefit of the contract rather than one which is incidental.

THIRD-PARTY BENEFICIARY

When contracts do not contain express third-party beneficiary clauses, it is up to the court to determine whether a third party is an intended third-party beneficiary. When determining whether a third party is an intended third-party beneficiary to a contract, the benefit and/or the beneficiary need not be expressly written in the contract; rather, the intent can be derived from the terms of the agreement and/or the surrounding circumstances including through typical courses of dealing.

THE CLAIMED BENEFIT

One who is not an express party to a contract may bring an action on a contract if the parties to the agreement intended to directly benefit the non-party, rather than unintentionally create an

incidental benefit. For example, when a contracting party enters into a proper contract with the intent that it secures a benefit on behalf of a contractor or an owner, a direct benefit exists.

Courts have held that certain agreements, such as collective-bargaining agreements, where it is widely known that these agreements contain certain conditions which are incorporated into or part of separate contracts, confer a direct benefit. If necessary, one could argue that subcontracts and sub-subcontracts are agreements simply containing conditions which are part of a larger contract.

A TWO-STEP BATTLE

When a contract expressly names a third-party beneficiary, and when that contract expressly states that the third-party beneficiary gains a direct benefit from the contract, a court of law does not have to determine if a party who is attempting to enforce a contract is an intended, direct third-party beneficiary to the contract. However, if a contract fails to expressly name a third-party beneficiary, an owner or a contractor must first prove that they have a right to enforce a contract before obtaining contractual enforcement. This is typically a question of law for the court.

A SIMPLE REMEDY

Generally, courts of law favor express terms in a contract versus terms that have to be interpreted or terms which are missing from the contract. To avoid extra costs of enforcement and litigation, contractors should reformulate their agreements to contain express provisions naming the owner and the contractor as an express third-party beneficiary to the contract. Likewise, contractors should require any sub-subcontracts to include the owner and the contractor as express third-party beneficiaries to the contract.

Rewriting contracts and naming the owner and the contractor as third-party beneficiaries on the front-end of a project can decrease costs of legal representation and litigation on the back-end of a project. If there is an issue with a project, naming a contractor as a direct third-party beneficiary may create an avenue for a contractor to bring an action against a subcontractor

or a sub-subcontractor on its own rather than an action for reimbursement after going through a legal quarrel with an owner. The contractor now only has one legal issue to handle. Additionally, the contractor and the owner can combine forces to enforce subcontractor contracts saving everyone time and money.

Giving yourself and the owner of a project the ability to enforce terms of a contract through express third-party beneficiary clauses should be an everyday practice. For example, if you, the contractor, are purchasing specialized materials for a project, make sure that the purchase order states "for the benefit of (f/b/o) X owner." A simple "f/b/o clause" could save you time and money when it comes to enforcement.

CLOSING THOUGHT

The labyrinth of construction contracts need not bring an extra level of complexity to a construction project when risks are mitigated with clauses

such as express third-party beneficiary clauses from the outset of a project. While each jurisdiction is different in the enforcement of contracts, placing express terms into all of your project documents may lessen any legal burden that arises from a project. ■

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