



Weekly Information Sheet 08

Contract Rules and Interpretation

Definition of Contract:

“An agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law.”

Elements of a Contract include:

- *Agreement,*
- *Between Competent Parties,*
- *Based on Genuine Assent,*
- *Supported by Consideration,*
- *for Lawful Purpose Subject Matter,*
- *in Legal Form.*

Third Party Beneficiaries

Third Party Beneficiaries:

Ordinarily, only the parties to a contract may sue on it. This is a concept known as “**privity of contract**”. In certain cases, however, a third person, who is not a party, but who is a beneficiary of the contract may sue.

Definitions:

Third Party Beneficiary: *“A Person who, though not a party to a contract, stands to benefit from the contract’s performance.”*

Privity of Contract: *“The relationship between the parties to a contract, allowing them to sue each other but preventing an outside third party from doing so.”*

Third-Party Beneficiary Contracts: When a contract is intended to benefit a third person, in certain circumstances, such a person is an intended third-party beneficiary, and may bring suit on and enforce the contract.

Creditor Beneficiary: *An intended beneficiary is sometimes classified as a creditor beneficiary when the promisee’s primary intent is to discharge a duty owed to the third party (and thus the beneficiary is deemed to have provided some degree of consideration for the benefit).*

Donee Beneficiary: *A second type of intended beneficiary is a donee beneficiary to whom the promisee’s primary intent in contracting is to give a benefit. A life insurance contract is such an intended third-party beneficiary contract. Such an individual third-party beneficiary has a right to sue under a broad range of insurance policies.*

Necessity of Intent: A third person does not have the status of an intended third-party beneficiary unless it is clear at the time the contract was formed, that the parties intended to impose a direct obligation with respect to the third person.

In determining whether there is intent to benefit a third party, the surrounding circumstances as well as the contract must be examined. There is a strong presumption in the law, however, that the parties to a contract intend to benefit only themselves.

Third Party Beneficiaries (Continued)

Intended and Incidental Beneficiaries:

Incidental Beneficiaries: Are persons whose benefit was purely a fortuitous and incidental result of a transaction between others. The contracting parties may have been pleased, indifferent, or resentful to see someone else derive benefits from their contract, but the parties did not make the contract for the purpose of conferring third-party benefits;

Intentional Beneficiaries: In contrast to these more commonplace situations in which the positive effects of the contract on a third party occur merely by happenstance, a contract may be entered for the deliberate purpose of bestowing a benefit, and more importantly, a power to enforce that benefit, on a third party. Such persons are intentional beneficiaries. These contracts properly describe the benefit of a third party manifesting the intent to give such benefit to a third party, which is directly enforceable by that third party, against the contracting party who undertakes to perform it. It is the creation of this directly enforceable right, that is the hallmark of a contract for the benefit of an intentional third party beneficiary. **These beneficiaries are given the right of Independent Enforcement.**

Means of Modification and/or Termination:

Assent of the Parties;

**Express Contractual Provision to Modify or Terminate Rights; and
Discharge, Operation of Law or Bankruptcy.**

Restrictions:

Vesting and Consent: The general rule is that the promisor may assert against an intended third party beneficiary any defense which he could assert against the promisee. The right to rescind or modify a third party beneficiary contract, without the assent of the beneficiary, ceases once the contract is accepted, adopted or acted upon by the intentional third party beneficiary. **The rights of the third party "vest" when they learn of the initial contract, and assent to it, or when they materially change their position in justifiable reliance on it, or when they bring suit on it.**

Qualification of Rights: As creators of the benefit, the contracting parties can confer it subject to whatever limitations and conditions they see fit. Thus the contract, can retain the power of the parties to modify it or take away a benefit even after any right has vested in the intended beneficiary. **Absent an express provision in the contract, however, allowing for the modification or termination of beneficiary rights, the contracting parties' power to alter these rights, terminates as soon as the benefit vests.**

Rights and Liabilities of Beneficiaries and Parties:

Intended Third-Party Beneficiary: Although the intended third-party beneficiary rule gives the third person the right to enforce the contract, it obviously gives no more rights than the contract provides. That is, the intended third-party beneficiary must take the contract as it is. Additionally, if the contract is not binding for any reason, that defense may be raised against the intended third-party beneficiary suing on the contract.

The Promisee's Parallel Rights of Enforcement Against the Promisor: Notwithstanding the conferral and vesting of rights in the beneficiary, the promisee continues to be a party to the contract. As such, except to the extent that the beneficiary has enforced and obtained satisfaction of the performance, the promisee has the right to enforce the promise just as they would have had in an ordinary bilateral contract.

The Promisor's Ability to Raise Defenses Against the Beneficiary: The beneficiary's rights derive from the contract, and as such, they are limited by any defense arising out of the contract. As a result, unless the contract makes it clear that it confers rights on the beneficiary free of defenses, the beneficiary's rights are subject to any limitations inherent in the contract.

Assignment and Delegation

Assignment and Delegation:

Ordinarily, The parties to a contract have both rights and duties. These rights and duties, under certain circumstances, can be transferred or sold to another person or entity. This is known as assignment and delegation.

Definitions:

Assignment: “The transfer of contractual rights to a third party.”

Delegation: “The act of entrusting another with authority to perform the duties of a contract.”

The Nature of an Assignment: An assignment is a voluntary manifestation of intention by the holder of an existing right to make an immediate transfer of that right to another person.

When a Right to be Assigned Comes into Existence: A right comes into existence and can be assigned as soon as the contract creating it has been formed, and such right can be conditional or not yet due at the time of assignment, so long as it has been created already.

The Nature of a Delegation: An obligor is entitled to delegate his contractual duties unless the delegation violates the terms of the contract or public policy.

What is Assignment and Delegation: Assignment and delegation involves a decision made by one of the parties, after the contract has been entered, to transfer his rights, or his duties, or both to a third party. Assignment and delegation are only possible once a contract has been made and those rights and obligations have come into existence.

General Rule: The well-established general rule, is that unless a contract specifically prohibits a party from transferring their rights acquired, and duties assumed thereunder, or the nature of the contract is such that the transfer would impair the other party’s reasonable expectations, or would offend public policy, a party has the power and ability to transfer contractual rights and obligations to another third person.

Rights vs. Duties: The transfer of rights is called an assignment, and the transfer of duties is a delegation.

Rights of Assignee: Unless restricted by the terms of the assignment or applicable law, the assignee acquires all the rights of the assignor. An assignee stands exactly in the position of the assignor. The assignee’s rights are no more or less than those of the assignor. If the assigned right to payment is subject to a condition precedent, that same condition exists for the assignee.

Assignment Form and Notice:

Form: Generally, **an assignment may be in any form**. Certain statutes, however, may require that some kinds of assignments must be in writing or be executed in a particular form.

Notice: An assignment, if otherwise valid, takes effect the moment it is made. As a result, **the assignee should give immediate notice** of the assignment to the obligor, setting forth the obligor’s duty to the assignee, in order to prevent improper payment.

Permissibility of Assignments:

Generally: Generally assignments of contracts are permissible unless they are expressly prohibited in the contract or are violative of public policy.

Prohibition of Assignment of Rights: A clear and specific contractual prohibition against the assignment of rights is enforceable at common law. Absent such a prohibition, or a prohibition based upon public policy, however, an assignment of rights is permissible.

Nonassignable Rights: If the transfer of a right would materially affect or alter a duty or the rights of the obligor, an assignment is not permitted.

Assignment and Delegation (Cont)

Liabilities of Assignors and Assignees:

Continuing Liability of Assignor: The making of an assignment does not relieve the assignor of any obligation of the contract. As a result, in the absence of a contrary agreement, an assignor continues to be bound by the obligations of the original contract. Upon assignment, the assignor could, however, seek indemnification from the assignee, for any breach caused by the assignee, in the event the other party to the contract seeks to hold the assignor liable.

Liability of Assignee: It is necessary to distinguish between the question of whether the obligor can assert a particular defense against the assignee and the question of whether any person can sue the assignee. Ordinarily, the assignee is not subject to suit by virtue of the fact that the assignment has been made.

Warranties of the Assignor: When the assignment is made for a consideration, the assignor is regarded as providing an **implied warranty that the right assigned is valid**. The assignor also warrants that the assignor is the owner of the claim or right assigned, and that the assignor will not interfere with the assignee's enforcement of the obligation.

Delegation – Duties Under the Contract:

Delegation: An obligor is generally entitled to delegate his contractual duties unless it violates an express provision of the contract or public policy.

Performance of the Contract: The effect of a permissible and effective delegation is that the delegator commits no breach of the contract by having his duty performed by the delegate, and the delegate's conforming performance discharges the delegator's contractual obligation. If a performance is properly delegated but the obligee refuses to accept it, this will be a breach by the obligee in the same way as it would have been to refuse the delegator's own performance.

Effect of Delegation of Duties: A delegation of duties is a transfer of duties by a contracting party to another person who is to perform them. Under certain circumstances, a contracting party may obtain someone else to do the work. When the performance is standardized and nonpersonal, so that it is not material who performs, the law will permit the delegation of the performance of the contract. In such cases, however, the contracting party remains liable in the case of default of the person doing the work just as though no delegation had been made.

A Requirement of Personal Performance: If the performance of a party to a contract requires the contractor, and no other person to perform the duties of the contract, such as where the performance involves personal skill, talents, judgment, or trust, the delegation of duties is barred unless consented to by the person entitled to the performance. Examples of this include contracts for performance by professionals such as physicians, dentists, lawyers, consultants, celebrities, artists, professional athletes and/or craftpersons with unusual skills.

Intention to Delegate Duties: An assignment of rights does not in itself delegate the performance of duties to the assignee. In the absence of clear language in the assignment stating that duties are or are not delegated, all circumstances must be examined to determine whether there is a delegation. When the total picture is viewed, it may become clear what was intended. The fact that an assignment is made for security of the assignee is a strong indication that there was no intent to delegate to the assignee the performance of any duty resting on the assignor.

Delegation of Duties under the UCC: With respect to contracts for the sale of goods, "an assignment of 'the contract' or of 'all my rights under the contract' or an assignment in similar general terms is an assignment of rights and, unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor, and its acceptance by the assignee constitutes a promise ... to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract."