

Third Party Beneficiary Claim against Subcontractor

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A city filed suit against an engineering subcontractor, asserting that the city was a third-party beneficiary of the subcontract. The subcontractor filed a motion for summary judgment, arguing that the city lacked privity of contract to file suit. The motion was denied because the city showed a clear intent by the parties of the subcontract to benefit the city; a duty was imposed on subcontractor in favor of the city; and the performance of the subcontract terms rendered the third party (city) a direct benefit that was intended by the parties to the contract.

City of Whiting v. Whitney, Bailey, Cox & Magnani, LLC, (U.S. District Court, N.D. Indiana, March 20, 2018).

In this case the city was developing a project to develop waterfront property along Lake Michigan. It hired an engineering firm, American Structurepoint, Inc., as the prime consultant on the project. That firm subcontracted with Whitney Bailey for marine engineering services. Specifically, Whitney was to design a rock revetment to be built along the shoreline for protection. The revetment failed three times according to the city's complaint.

The city filed suit against the prime consultant and that suit was settled. But the city sought to recover additional damages directly from the subconsultant. A number of theories of recovery were addressed by the court, including claims based on assignment, indemnity and economic loss. This current article, however, addresses on the issue of breach of contract based on third party beneficiary status.

The court began its analysis by explaining the three things a plaintiff must show in order to demonstrate that it is a third party beneficiary of a contract between other parties. The court states:

"A plaintiff must show: (1) [a] clear intent by the actual parties to the contract to benefit the third party; (2) [a] duty imposed on one of the contracting parties in favor of the third party; and (3) [p] erformance of the contract terms is necessary to render the third party a direct benefit intended by the parties to the contract."

For the first factor, in this case the court found that the subcontract demonstrated an intent to benefit the city because the city is referred to by name as the party for whom [Subconsultant's] engineering services are being performed," and the Prime Agreement was incorporated by reference into the subcontract stating that [Subconsultant] shall be obligated to the applicable provisions ... of the "Prime Agreement." The court states that this "certainly evinces either intent or awareness on the part of the parties that their actions would benefit the city."

The fact that the subcontract did not contain a "no third-party beneficiary" clause was also a consideration by the court. As put by the court, "This fact, by itself, does not prove any intent to create a third-party beneficiary. But, it also demonstrates the absence of any affirmative intent to avoid third party status."

For the second factor by which the city must demonstrate that the subcontract placed a duty on one of the contracting parties in the city's favor, the court explained that the incorporation of the Prime Agreement supported that conclusion and that the contract provision requiring transfer of ownership of the Subconsultant's instruments of service constituted the type of duty owed by the subconsultant needed to show third-party beneficiary rights of the city. "This duty [the transfer of documents ownership] on its own, is enough to satisfy this second prong...."

Another duty that satisfies the second prong is the duty that the subconsultant had to perform its services "in a manner consistent with that degree of skill and care ordinarily exercised by members of the same profession." The court stated that although the city was not explicitly mentioned in the same paragraph as this duty, the only reasonable conclusion is that "the performance of this duty will result in a direct benefit to the City, as intended by the parties."

The third prong was deemed satisfied by virtue of the fact that "the City will receive the direct benefit of the work to be done, and of any additional duties (including the duty regarding ownership of documents), as intended by the parties".

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