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Contracts--Subcontractors as Third Party Beneficiary of Contract Between State and Prime Contractor

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Recent Cases

Contracts—Subcontractors as Third Party Beneficiary of Contract between State and Prime Contractor.—The L. G. Wasson Coal Mining Corp., appellee, brought a contract action against the Commonwealth of Kentucky. Traylor Bros., Inc., the prime contractor, was to complete grade and drain work on a section of a highway construction project. Traylor had subcontracted the borrow pit excavation on a section of the project to the appellee.1 The appellee claimed that the appellant erroneously underestimated the amount of borrow pit excavation and sought payment for such excess excavation. The trial court upheld the appellee's cause of action on a third party beneficiary theory. Held: Reversed. This theory was unsustainable because the essential features of a third party beneficiary contract were not present. Commonwealth of Kentucky, Dep't of Highways v. L. G. Wasson Coal Mining Corp., 358 S.W.2d 347 (Ky. 1962).

Although the court correctly decided that the subcontractor could not be considered a third party beneficiary in this case, it is unfortunate that the court dismissed without discussion or explanation the applicability of third party beneficiary law, which was crucial to the trial court's judgment in favor of the subcontractor.2 The only clue the court gave as to its reasons for denying the subcontractor the status of a third party beneficiary was its citation of Road Improvement Dist. No. 1 v. Mobley Constr. Co.,3 an Arkansas case involving similar facts. In that case, the court refused to recognize the subcontractor as a third party beneficiary because such a contract does not inure to the benefit of anyone except the prime contractor, and there was no existing obligation of the promisor to the third party at the time of the making of the contract. The court said, in effect, that since the sub-

1 The prime contract provided that any subcontractor would be recognized by the Commonwealth only as an employee.
2 The court discussed more fully the other points on which it based its reversal: (1) the subcontractor could not recover on the ground that the cross-claim of the prime contractor against the Commonwealth was for the full amount due, when the cross-claim sought no recovery except as was conditional upon a recovery by the subcontractor; (2) there could be no recovery on the theory that the making of the subcontract constituted an assignment, since the subcontract did not purport to give the subcontractor any direct right to collect money payable by the state to the prime contractor; and (3) there could be no recovery on the theory that the prime contractor had assigned moneys due him from the state in a previous suit, and under the established rule against splitting a cause of action there was nothing left to assign.
3 171 Ark. 585, 286 S.W. 878 (1926).
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contractor's rights accrued subsequent to the prime contract, he was a mere incidental beneficiary acquiring no rights thereunder.

The American majority rule is that "a third person may enforce a promise made for his benefit even though he is a stranger to the contract and to the consideration."\(^4\) Intention to confer a benefit on the third party is essential to the right of the third party to enforce the promise, and this applies both to the donee and the creditor beneficiary.\(^5\) The real problem is to ascertain whether there exists a bona fide intent to benefit the third party. As applied to the principal case, the question becomes one of whether the construction contract between the state and the contractor was entered into for the benefit of the subsequent subcontractor. Previous Kentucky cases reveal a more liberal view than that indicated by the court's approval of the reasoning in the Arkansas case. As early as 1930, the Kentucky court allowed damages to a plaintiff suing as third party beneficiary to an agreement between a city and the prime contractor.\(^6\) The rule was stated as follows: "[A] contract is made for the benefit of a party who has a direct financial, legal, or equitable interest in its performance."\(^7\) In a later case, the court held that a contract between a state and an individual by which certain things were to be done, inured to the benefit of the individual who was interested in its performance.\(^8\) The plaintiff in that case was an employee of a subcontractor, and the prime contract stipulated that the contractor would pay for materials and labor. In still another case, the court upheld the rights of a third party who had relied upon a contract made between others.\(^9\)

Denying recovery by the subcontractor because there was no existing obligation to him at the time the contract was made lacks support in the majority of cases in Kentucky and other jurisdictions. The creation of a right in either a donee or creditor beneficiary does not require that he be identified when a contract containing a promise is made.\(^10\) The third party need not be known, nor need he even be in existence when the promise is made.\(^11\) It is sufficient if he be in existence and be identified at the time when performance of the promise is due. How then can an existing obligation to a third party

\(^7\) Id. at 649, 29 S.W.2d at 652.
\(^8\) J. T. Jackson Lumber Co. v. Union Transfer & Storage Co., 246 Ky. 653, 55 S.W.2d 670 (1932).
\(^10\) Restatement, Contracts § 139 (1932).
be required when it is not even required, that the third party be in existence?

It can be argued that the subcontractor in the principal case was one who had a financial interest in or had relied upon the prime contract. Furthermore, the fact that there was no existing obligation from the contracting parties to this particular subcontractor at the time of the contract's execution is irrelevant. The reasons given by the Arkansas court, therefore, do not explain satisfactorily why the subcontractor fails to achieve the status of a third party beneficiary. The most satisfactory explanation for denying him this status is that the contract contained no express provisions stipulating that either of the contracting parties would be liable for damages to a subcontractor. Courts generally refuse to imply such a provision in cases of this nature. The law governing this point can be more clearly understood by considering the construction contract cases in which a bond is given by the contractor requiring him to pay for all materials and labor. As the Kentucky court has said:

We have in Kentucky two distinct lines of decisions in cases of this character. If the bond, when read in connection with the contract, contains a provision obligating the contractor to pay for the material, or to compensate the laborers, it constitutes a provision for the benefit of the laborers and material-men. . . . On the other hand, when the bond is one solely to secure performance of the contract and contains no language from which an express covenant for the benefit of third parties may be derived, an action thereon by a stranger to the contract may not be maintained.

According to the weight of authority, a person furnishing materials or labor may recover on a building contractor's bond where it contains a condition for his benefit. But where neither the contract nor the bond contains a provision for payment of labor and materials, there can be no action by the subcontractor on the third party beneficiary theory.

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12 In Road Improvement Dist. No. 1 v. Mobley Constr. Co., supra note 3, the Arkansas court quoted from an earlier case, Dickenson v. McCoppin, 121 Ark. 414, 181 S.W. 151 (1915):

Where a contract is made between a promisee and a promisor for the benefit of a third party, in order that the third party may sue the promisor for a breach of the contract, the obligation of the promisor to the third party must be one . . . which grew out of the contract itself. . . . This language indicates that the third party beneficiary could not be sustained without an express provision in the contract allowing damages to the subcontractor. But instead of using this approach, the court based its decision on the fact that there was no existing obligation to the third party at the time of the contract's execution.


If a subcontractor cannot recover as a third party beneficiary under a contractor's bond because it contains no provision for his benefit, a fortiori, he cannot recover under such a contract without bond for the same reason. The general rule is that where a contract for public work has been let without obtaining from the contractor the statutory bond, there is no liability to the subcontractor. Since the contract between the state and the prime contractor contained no express provision for the benefit of the subcontractor, the court in the principal case correctly decided that the subcontractor was not a third party beneficiary. For this reason, the subcontractor's action fails, and not, as suggested in the Arkansas case, because of the absence of an existing obligation to him at the time the prime contract was executed.

Tommy W. Chandler

CONSTITUTIONAL LAW—STATE ACTION—REAL ESTATE DISCRIMINATION.

—Real estate brokers in Detroit brought action to enjoin the enforcement of a rule of the Michigan Corporation and Securities Commission, which prohibited discrimination by real estate brokers, salesmen, and agents because of race, color, religion, ethnic origin or ancestry. The commission is authorized by the legislature to revoke a real estate broker's license for dishonest and unfair dealing, and to enumerate additional grounds of such conduct and "make rules in harmony with the subject matter legislated upon."

The basis of the action is that the commission had exceeded its rule-making power. The Commission and amici curiae contended that, because of the vital importance to the state of the functions performed by the licensed real estate brokers, discrimination on the basis of race, color, creed or ancestry constitutes discriminatory state action in violation of the fourteenth amendment by not affirmatively prohibiting such practice. The circuit court decreed the injunction sought and the

10 Annot., 64 A.L.R. 678 (1929).
1 For a discussion of the rule which is the subject of this litigation, see Kinsey, Rule Nine—A Novel Approach?, 39 U. Det. L.J. 108 (1961).
5 American Jewish Congress, American Civil Liberties Union of Michigan, National Association for the Advancement of Colored People, American Jewish Committee, and the Anti-Defamation League of the B'nai B'rith.