

Preventing Third Party Beneficiary Claims

The “Great Recession” has hit the construction industry particularly hard. Employment within the industry has fallen over 28% since 2006 and is still shrinking. Residential housing starts have declined 72% since 2005. While recent statistics suggest some improvement, the economic environment remains very challenging for owners and their agents, and for the other parties involved in construction projects.

Perhaps as a result of the economic decline, lawsuits brought by contractors on novel theories seem to be increasing. One theory that is increasingly used by contractors is that the contractor is an intended third party beneficiary of the contract between the design professional and the owner. A thorough understanding of how such claims may be brought or prevented, as well as an understanding of the duty a construction manager owes to an owner, is necessary to preclude such claims from occurring.

A construction manager, as the owner’s representative, has a duty imposed by California case law to protect the interests of the owner. See *Ratcliff Architects v. Vanir Constr. Mgt., Inc.*, 88 Cal. App. 4th 595, 605 (2001). A typical duty of a construction manager is to oversee the owner’s contracts with the project’s design professional and the contractor. A construction manager should be well-aware of how to protect the owner from third party beneficiary claims by ensuring that the contracts conform to California law disclaiming any liability for such claims.



California law defines a third party beneficiary contract as, one “made expressly for the benefit of a third person.” SEE CAL. CIV. CODE § 1559. “Whether one is third party beneficiary depends upon the intent of the parties as manifested by the terms of the contract. However, where a contract incidentally benefits a third person but is not made expressly for his benefit, he cannot recover [as a third party beneficiary].” See *Martinez v. Socoma Companies, Inc.*, 11 Cal.3d 394 (1974); *City and County of San Francisco v. Western Air Lines, Inc.*, 204 Cal. App. 2d 105, 121 (1962).

For example, in *Jones v. Aetna Casualty & Surety Company*, Jones leased a restaurant; the lease agreement provided that the lessor would maintain rental insurance, with loss benefits payable to the lessor but with the policy being at Jones’ expense. 26 Cal. App. 4th 1717, 1721-22 (1994). The lease also provided that Jones’ rent would be reduced during the period of time post-loss repairs were made, but only to the extent that the lessor received the insurance proceeds. The property eventually sustained a loss that caused Jones to lose customers to such an extent that he vacated the premises. The insurer refused to cover the loss. Jones sued the insurer. The trial court sustained the insurer’s demurrer without leave to amend.

The Court of Appeal affirmed the order of dismissal and rejected Jones’ argument that he was a third party beneficiary of the insurance contract between the lessor and the insurer. The Court reviewed the contract and determined that the parties clearly intended that the contract was for their own benefit, and not for the benefit of Jones. The Court held that the fact Jones was an incidental beneficiary of the insurance contract did not give him standing to sue the insurer.

Jones is consistent with *Lundeen Coatings Corporation v. Department of Water and Power*. 232 Cal. App. 3d 816 (1991). There, a subcontractor tried to sue a construction manager, alleging that it was a third party beneficiary of the owner’s contract. The Court of Appeal rejected that argument, finding no

express intent of the contract's parties to benefit the subcontractor. The subcontractor was, at most, an incidental beneficiary under the contract and not entitled to recovery. *Id.* at 834.

Similarly, in *Ratcliff Architects v. Vanir Constr. Management, Inc.*, the Court of Appeal rejected the argument that the contractor was a third party beneficiary because the contract at issue specifically excluded third party beneficiaries. 88 Cal. App. 4th 595, 605 (2001).

These cases provide guidance for how construction managers can fulfill their duty owed to the owner. In order to avoid entangling the owner in future lawsuits, a construction manager should ensure that all of the owner's contracts expressly disclaim third party beneficiaries. Further, the contract should state that the contract is only for the express benefit of the contract's parties. By doing so, the construction manager may foreclose a lawsuit based upon a third party beneficiary theory, at least make one almost impossible for a subcontractor to successfully pursue. This will eliminate one further claim against which an owner may have to defend in any future litigation.

Christian A. Carrillo

Morris Polich & Purdy LLP

CCarrillo@mpplaw.com



Christian A. Carrillo is an associate with the Los Angeles office of Morris Polich & Purdy LLP. He has represented owners, general contractors, and construction managers in complex, contractual litigation, and also litigates delay and defect claims. Mr. Carrillo also litigates commercial actions involving trade secrets, trademarks, copyrights, and false advertising, and has extensive experience with actions brought under the False Claims Act and in administrative proceedings brought by public entities.